

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004.

OR

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

For the transition period from _____ to _____

Commission file number 1-8957

ALASKA AIR GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

91-1292054
(I.R.S. Employer
Identification No.)

19300 Pacific Highway South, Seattle, Washington 98188
(Address of principal executive offices)

Registrant's telephone number, including area code: (206) 392-5040

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The registrant has 26,886,515 common shares, par value \$1.00, outstanding at September 30, 2004.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

| | |
|-------------------------|---|
| Item 1. | Condensed Consolidated Financial Statements |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk |
| Item 4. | Controls and Procedures |

PART II. OTHER INFORMATION

| | |
|-------------------------|---|
| Item 1. | Legal Proceedings |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds |
| Item 3. | Default on Senior Securities |
| Item 4. | Submission of Matters to a Vote of Security Holders |
| Item 5. | Other Information |

[Signatures](#)

[Exhibits](#)

[EXHIBIT 4.1](#)

[EXHIBIT 10.19](#)

[EXHIBIT 31.1](#)

[EXHIBIT 31.2](#)

[EXHIBIT 32.1](#)

[EXHIBIT 32.2](#)

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements that relate to future events of our future financial performance and involve a number of risks and uncertainties. These forward-looking statements are intended to be subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In some cases, you can identify forward-looking statements by terminology such as “forecast,” “may,” “will,” “could,” “should,” “expect,” “plan,” “believe,” “potential” or other similar words indicating future events or contingencies. Some of the things that could cause our actual results to differ from our expectations are: changes in our operating costs including fuel; the competitive environment and other trends in our industry; economic conditions; our reliance on automated systems; actual or threatened terrorist attacks, global instability and potential U.S. military involvement; our ability to meet our cost reduction goals; the outcome of contract talks with the Air Line Pilots Association, whether as a result of negotiations or binding arbitration; labor disputes; changes in laws and regulations; liability and other claims asserted against us; failure to expand our business; interest rates and the availability of financing; our ability to attract and retain qualified personnel; changes in our business plans; our significant indebtedness; downgrades of our credit ratings; and inflation. For a discussion of these and other risk factors, review the information under the caption “Business — Business Risks” in Item 1 of the Company’s Annual Report on Form 10-K/A for the year ended December 31, 2003. All of the forward-looking statements are qualified in their entirety by reference to the risk factors discussed therein. Our forward-looking statements are based on the information currently available to us and speak only as of the date of this report. You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this report to conform them to actual results. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such differences might be significant and materially adverse.

PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

Alaska Air Group, Inc.

ASSETS

| (In Millions) | December 31, 2003 | September 30, 2004 |
|--|----------------------|-----------------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 192.9 | \$ 222.9 |
| Marketable securities | 619.4 | 655.6 |
| Receivables - net | 120.7 | 120.5 |
| Inventories and supplies — net | 45.8 | 47.4 |
| Deferred income taxes | 90.6 | 75.3 |
| Prepaid expenses and other current assets | 78.9 | 169.5 |
| Total Current Assets | 1,148.3 | 1,291.2 |
| Property and Equipment | | |
| Flight equipment | 2,327.6 | 2,287.0 |
| Other property and equipment | 464.2 | 466.9 |
| Deposits for future flight equipment | 78.1 | 61.8 |
| | 2,869.9 | 2,815.7 |
| Less accumulated depreciation and amortization | 920.7 | 898.6 |
| Total Property and Equipment — Net | 1,949.2 | 1,917.1 |
| Intangible Assets | 45.6 | 44.6 |
| Other Assets | 116.1 | 156.2 |
| Total Assets | \$ 3,259.2 | \$ 3,409.1 |

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

Alaska Air Group, Inc.

LIABILITIES AND SHAREHOLDERS' EQUITY

| (In Millions) | December 31, 2003 | September 30, 2004 |
|---|----------------------|-----------------------|
| Current Liabilities | | |
| Accounts payable | \$ 132.9 | \$ 139.3 |
| Accrued aircraft rent | 75.6 | 71.6 |
| Accrued wages, vacation and payroll taxes | 92.7 | 121.5 |
| Other accrued liabilities | 271.8 | 290.6 |
| Air traffic liability | 237.7 | 279.9 |
| Current portion of long-term debt and capital lease obligations | 206.7 | 52.1 |
| Total Current Liabilities | <u>1,017.4</u> | <u>955.0</u> |
| Long-Term Debt and Capital Lease Obligations | <u>906.9</u> | <u>1,007.6</u> |
| Other Liabilities and Credits | | |
| Deferred income taxes | 192.0 | 208.3 |
| Deferred revenue | 252.4 | 291.2 |
| Other liabilities | 216.3 | 233.4 |
| | <u>660.7</u> | <u>732.9</u> |
| Commitments and Contingencies | | |
| Shareholders' Equity | | |
| Preferred stock, \$1 par value | | |
| Authorized: 5,000,000 shares | — | — |
| Common stock, \$1 par value | | |
| Authorized: 100,000,000 shares | | |
| Issued: 2003 - 29,474,919 shares | | |
| 2004 - 29,593,158 shares | 29.5 | 29.6 |
| Capital in excess of par value | 486.3 | 488.4 |
| Treasury stock, at cost: 2003 - 2,712,979 shares | | |
| 2004 - 2,706,643 shares | (61.9) | (61.8) |
| Accumulated other comprehensive income (loss) | (79.0) | (76.7) |
| Retained earnings | 299.3 | 334.1 |
| | <u>674.2</u> | <u>713.6</u> |
| Total Liabilities and Shareholders' Equity | <u>\$ 3,259.2</u> | <u>\$ 3,409.1</u> |

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

Alaska Air Group, Inc.

Three Months Ended September 30
(In Millions Except Per Share Amounts)

| | 2003 | 2004 |
|--|-----------------------|----------------|
| | Revised (See Note 13) | |
| Operating Revenues | | |
| Passenger | \$ 645.8 | \$ 706.0 |
| Freight and mail | 22.6 | 25.5 |
| Other — net | 33.8 | 42.3 |
| Total Operating Revenues | <u>702.2</u> | <u>773.8</u> |
| Operating Expenses | | |
| Wages and benefits | 237.9 | 247.0 |
| Contracted services | 24.4 | 21.2 |
| Aircraft fuel | 96.8 | 148.4 |
| Aircraft maintenance | 42.4 | 37.0 |
| Aircraft rent | 49.2 | 46.7 |
| Food and beverage service | 17.6 | 14.3 |
| Other selling expenses and commissions | 36.1 | 37.5 |
| Depreciation and amortization | 32.7 | 35.7 |
| Loss (gain) on sale of assets | 0.1 | (2.8) |
| Landing fees and other rentals | 43.3 | 48.0 |
| Other | 45.0 | 48.1 |
| Restructuring charges | — | 27.5 |
| Total Operating Expenses | <u>625.5</u> | <u>708.6</u> |
| Operating Income | <u>76.7</u> | <u>65.2</u> |
| Nonoperating Income (Expense) | | |
| Interest income | 5.5 | 7.9 |
| Interest expense | (13.3) | (13.6) |
| Interest capitalized | 0.4 | 0.5 |
| Other — net | (1.1) | 67.6 |
| | <u>(8.5)</u> | <u>62.4</u> |
| Income before income tax | 68.2 | 127.6 |
| Income tax expense | 27.5 | 48.4 |
| Net Income | <u>\$ 40.7</u> | <u>\$ 79.2</u> |
| Basic Earnings Per Share | <u>\$ 1.53</u> | <u>\$ 2.95</u> |
| Diluted Earnings Per Share | <u>\$ 1.52</u> | <u>\$ 2.94</u> |
| Shares used for computation: | | |
| Basic | 26.660 | 26.862 |
| Diluted | 26.796 | 26.932 |

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

Alaska Air Group, Inc.

Nine Months Ended September 30
(In Millions Except Per Share Amounts)

| | 2003 | 2004 |
|--|-----------------------|----------------|
| | Revised (See Note 13) | |
| Operating Revenues | | |
| Passenger | \$ 1,678.2 | \$1,896.7 |
| Freight and mail | 63.6 | 68.3 |
| Other - net | 89.7 | 105.9 |
| Total Operating Revenues | 1,831.5 | 2,070.9 |
| Operating Expenses | | |
| Wages and benefits | 697.5 | 733.9 |
| Contracted services | 74.5 | 81.7 |
| Aircraft fuel | 270.5 | 384.8 |
| Aircraft maintenance | 140.2 | 137.9 |
| Aircraft rent | 146.1 | 141.5 |
| Food and beverage service | 46.6 | 39.5 |
| Other selling expenses and commissions | 99.1 | 111.5 |
| Depreciation and amortization | 98.2 | 105.8 |
| Loss (gain) on sale of assets | 0.2 | (1.4) |
| Landing fees and other rentals | 120.6 | 136.2 |
| Other | 139.3 | 146.3 |
| Restructuring charges | — | 27.5 |
| Impairment of aircraft and spare engines | — | 39.6 |
| Total Operating Expenses | 1,832.8 | 2,084.8 |
| Operating Loss | (1.3) | (13.9) |
| Nonoperating Income (Expense) | | |
| Interest income | 11.5 | 18.6 |
| Interest expense | (38.6) | (38.9) |
| Interest capitalized | 1.9 | 1.1 |
| U.S. government compensation | 71.4 | — |
| Other — net | 8.2 | 93.8 |
| | 54.4 | 74.6 |
| Income before income tax | 53.1 | 60.7 |
| Income tax expense | 23.5 | 25.9 |
| Net Income | \$ 29.6 | \$ 34.8 |
| Basic Earnings Per Share | \$ 1.11 | \$ 1.30 |
| Diluted Earnings Per Share | \$ 1.11 | \$ 1.29 |
| Shares used for computation: | | |
| Basic | 26.621 | 26.820 |
| Diluted | 26.680 | 26.922 |

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (unaudited)

Alaska Air Group, Inc.

| (In Millions) | Common Shares Outstanding | Common Stock | Capital in Excess of Par Value | Treasury Stock, at Cost | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total |
|--|---------------------------------|-----------------------|--------------------------------------|-------------------------------|--|------------------------|------------------------|
| Balances at December 31, 2003: | <u>26.762</u> | <u>\$ 29.5</u> | <u>\$ 486.3</u> | <u>\$ (61.9)</u> | <u>\$ (79.0)</u> | <u>\$ 299.3</u> | <u>\$ 674.2</u> |
| Net income for the nine months ended September 30, 2004 | | | | | | 34.8 | 34.8 |
| Other comprehensive income (loss): | | | | | | | |
| Officers supplemental retirement plan net of \$0.4 tax benefit | | | | | 0.7 | | 0.7 |
| Related to marketable securities: | | | | | | | |
| Change in fair value | | | | | (3.5) | | |
| Reclassification to earnings | | | | | 0.5 | | |
| Income tax effect | | | | | 1.1 | | |
| | | | | | <u>(1.9)</u> | | <u>(1.9)</u> |
| Related to fuel hedges: | | | | | | | |
| Change in fair value | | | | | 18.1 | | |
| Reclassification to earnings | | | | | (12.5) | | |
| Income tax effect | | | | | <u>(2.1)</u> | | |
| | | | | | <u>3.5</u> | | <u>3.5</u> |
| Total comprehensive loss | | | | | | | <u>37.1</u> |
| Treasury stock sales | 0.007 | — | — | 0.1 | | | 0.1 |
| Stock issued for employee stock purchase plan | 0.103 | 0.1 | 1.8 | — | | | 1.9 |
| Stock issued under stock plans | 0.015 | — | 0.3 | — | | | 0.3 |
| Balances at September 30, 2004 | <u>26.887</u> | <u>\$ 29.6</u> | <u>\$ 488.4</u> | <u>\$ (61.8)</u> | <u>\$ (76.7)</u> | <u>\$ 334.1</u> | <u>\$ 713.6</u> |

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Alaska Air Group, Inc.

| Nine Months Ended September 30 (In Millions) | 2003 | 2004 |
|---|-----------------|-----------------|
| Cash flows from operating activities: | | |
| Net income | \$ 29.6 | \$ 34.8 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Impairment of aircraft and spare engines | — | 39.6 |
| Depreciation and amortization | 98.2 | 105.8 |
| Amortization of airframe and engine overhauls | 47.8 | 48.3 |
| Changes in fair values of fuel hedges | 1.8 | (80.4) |
| Loss (gain) on sale of assets | 0.1 | (1.4) |
| Increase in deferred income taxes | 23.6 | 31.6 |
| (Increase) decrease in receivables - net | (16.3) | 0.2 |
| Increase in prepaid expenses and other current assets | (1.6) | (13.8) |
| Increase in air traffic liability | 54.2 | 42.2 |
| Increase in other current liabilities | 22.0 | 50.5 |
| Increase in deferred revenue and other-net | 13.1 | 26.1 |
| Net cash provided by operating activities | 272.5 | 283.5 |
| Cash flows from investing activities: | | |
| Proceeds from disposition of assets | 3.1 | 11.1 |
| Purchases of marketable securities | (695.2) | (637.9) |
| Sales and maturities of marketable securities | 535.3 | 598.7 |
| Property and equipment additions: | | |
| Aircraft purchase deposits | (35.3) | (10.3) |
| Capitalized overhauls | (56.1) | (44.1) |
| Aircraft | (194.4) | (41.7) |
| Other flight equipment | (12.1) | (22.0) |
| Other property | (22.8) | (25.7) |
| Aircraft deposits returned | 1.2 | 19.2 |
| Restricted deposits and other | (32.3) | (4.5) |
| Net cash used in investing activities | (508.6) | (157.2) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term debt, net | 247.0 | 94.6 |
| Long-term debt and capital lease payments | (60.3) | (193.2) |
| Proceeds from issuance of common stock | 2.1 | 2.3 |
| Net cash provided by (used in) financing activities | 188.8 | (96.3) |
| Net change in cash and cash equivalents | (47.3) | 30.0 |
| Cash and cash equivalents at beginning of period | 269.0 | 192.9 |
| Cash and cash equivalents at end of period | \$ 221.7 | \$ 222.9 |
| Supplemental disclosure of cash paid (refunded) during the period for: | | |
| Interest (net of amount capitalized) | \$ 31.1 | \$ 34.8 |
| Income taxes | (0.1) | (39.6) |
| Noncash investing and financing activities: | | |
| Assets acquired under long-term debt | — | 44.7 |

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Alaska Air Group, Inc.

Note 1. Basis of Presentation and Significant Accounting Policies

Organization and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Alaska Air Group, Inc. (Air Group or the Company) include the accounts of the parent company, Alaska Air Group, Inc., and its principal subsidiaries, Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon), through which the Company conducts substantially all of its operations. These interim condensed consolidated financial statements are unaudited and should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2003. In the opinion of management, all adjustments have been made which are necessary to present fairly the Company's financial position as of September 30, 2004, as well as the results of operations for the three and nine months ended September 30, 2003 and 2004. The adjustments made were of a normal recurring nature.

The Company's condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). In preparing these condensed consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities, as well as the reported amounts of revenues and expenses. Significant estimates made include assumptions used to record liabilities, expenses and revenues associated with the Company's Mileage Plan, lease return provisions, the fair market value of surplus or impaired aircraft, engines and parts, assumptions used in the calculation of pension expense in the Company's defined benefit plans and the amounts of certain accrued liabilities. Actual results may differ from the Company's estimates.

Stock Options

The Company has awards outstanding under five long-term incentive equity plans, one of which continues to provide for the grant of stock options to purchase Air Group common stock at market prices on the date of the grant to officers and employees of Air Group and its subsidiaries. The Company applies the intrinsic value method in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations, in accounting for stock options. Accordingly, no compensation cost has been recognized for these plans as the exercise price of options equals the fair market value on the date of grant.

The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of Statement on Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," to its stock-based employee compensation (in millions, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Net income: | | | | |
| As reported | \$ 40.7 | \$ 79.2 | \$ 29.6 | \$ 34.8 |
| Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects | (1.4) | (1.1) | (4.6) | (3.4) |
| Pro forma net income | \$ 39.3 | \$ 78.1 | \$ 25.0 | \$ 31.4 |
| Basic earnings per share: | | | | |
| As reported | \$ 1.53 | \$ 2.95 | \$ 1.11 | \$ 1.30 |
| Pro forma | 1.47 | 2.91 | 0.94 | 1.17 |
| Diluted earnings per share: | | | | |
| As reported | \$ 1.52 | \$ 2.94 | \$ 1.11 | \$ 1.29 |
| Pro forma | 1.47 | 2.90 | 0.94 | 1.17 |

Note 2. Restructuring Charges

During the third quarter of 2004, the Company announced a management reorganization and the closure of its Oakland maintenance base, contracting out of the Company's Fleet Service, Ground Equipment and Facility maintenance functions and other initiatives. In total, these restructuring activities are expected to result in a reduction of approximately 900 employees when fully implemented in 2005. Severance and related costs associated with this restructuring are estimated at \$50-\$55 million, of which \$27.5 million was recorded during the third quarter of 2004 and \$23 to \$27 million will be recorded in the fourth quarter. The Company is also currently evaluating any possible asset impairment that may result from the announced initiatives. Any impairment charge would be in addition to the severance estimates above.

The following table displays the activity and balances of the restructuring charges for the three and nine months ended September 30, 2004. There were no restructuring charges during the same period of 2003 (\$ in millions):

| Severance and Related Costs | |
|-------------------------------|--------|
| Balance at December 31, 2003 | \$ — |
| Restructuring charges | 27.5 |
| Cash payments* | (1.2) |
| Balance at September 30, 2004 | \$26.3 |

* The Company expects the majority of cash payments will be made during the first and second quarters of 2005.

Note 3. Impairment of Aircraft and Related Spare Engines

Impairment of 737-200C Aircraft

In June 2004, the Company's Board approved a plan to accelerate the retirement of its Boeing 737-200C fleet and remove those aircraft from service (by the end of 2007) earlier than initially planned. In July 2004, the Company announced its plan to replace these aircraft by modifying five existing 737-400 aircraft and using other existing 737-400 aircraft for the remaining passenger capacity. Four of the five modified airplanes will be converted into combination passenger/cargo aircraft and one will be converted to an all cargo aircraft. The Company expects to backfill the 737-400s with Boeing 737-800s to be delivered in 2005 and 2006.

As a result of this decision, the Company evaluated impairment as required by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and concluded that the carrying value of the 737-200C fleet was no longer recoverable when compared to the estimated remaining future cash flows. Accordingly, during the second quarter of 2004, the Company recorded an impairment charge totaling \$36.8 million (pretax) to write down the fleet to its estimated fair market value.

The estimated fair value of the Company's aircraft was derived using third-party appraisals and market data compiled by an independent pricing authority, and adjusted for other factors that management deemed appropriate. In conjunction with the fair value determination, the Company has reassessed the useful lives and residual values of the fleet and related spare equipment and will depreciate the remaining carrying values through 2007 when the last aircraft will be retired.

Impairment of F-28 Aircraft and Related Spare Engines

During the first and second quarters of 2004, Horizon recorded impairment charges of \$2.4 million and \$0.4 million, respectively, associated with its F-28 aircraft and spare engines to lower the carrying value of these assets to their estimated net realizable value.

Note 4. Derivative Financial Instruments

The Company's operations are inherently dependent upon the price and availability of aircraft fuel, which accounted for 15% and 19% of year-to-date 2003 and 2004 operating expenses (excluding impairment and restructuring charges), respectively. To manage economic risks associated with fluctuations in aircraft fuel prices, the Company enters into swap agreements and call options for crude oil. Prior to the second quarter of 2004, these hedging contracts were "highly correlated" to changes in aircraft fuel prices, and therefore qualified as "cash flow hedges" under SFAS No. 133 whereby the majority of the changes in fair value were deferred in Accumulated Other Comprehensive Income on the Company's Balance Sheet until these hedge positions were settled at which point they were recognized in earnings.

The Company's current fuel hedge program includes the same underlying commodities used historically. However, because of variations in the spread between the prices of crude oil and jet fuel since April 1, 2004, the Company's hedge contracts are no longer "highly correlated" to changes in prices of aircraft fuel, as defined in SFAS No. 133. The impacts on the Company's reported results are as follows:

[Table of Contents](#)

- All changes in the fair value of fuel hedge contracts that existed as of March 31, 2004 or hedge positions entered into subsequent to March 31, 2004 (the end of the first quarter of 2004) are reported in other non-operating income (expense).
- Because the Company will be recording fair value changes in its consolidated statement of operations as they occur (in non-operating income (expense)), actual gains or losses realized upon settlement of the hedge contracts entered into subsequent to March 31, 2004 will not be reflected in fuel expense.
- Reported fuel expense will include the effective portion of gains associated with hedge positions that settled during the current period on contracts that existed at March 31, 2004 to the extent that mark-to-market gains were already included in Accumulated Other Comprehensive Income at March 31, 2004.

The following table summarizes realized fuel hedging gains and changes in fair value of hedging contracts outstanding as of September 30, 2004 and 2003 (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Settled hedging gains included in aircraft fuel | \$ 5.1 | \$ 4.0 | \$ 16.5 | \$ 12.5 |
| Settled hedging gains (losses) included In non-operating income (expense)*** | \$ (0.8) | \$ 9.7 | \$ 4.3 | \$ 13.3 |
| Mark-to-market hedging gains included in non-operating income (expense)** | \$ — | \$ 57.2 | \$ — | \$ 80.0 |
| Hedging gains included in non-operating income (expense)* | \$ (0.8) | \$ 66.9 | \$ 4.3 | \$ 93.3 |

* Includes the ineffective portion recorded currently in earnings using “hedge accounting” through the first quarter of 2004.

** Includes changes in fair value since March 31, 2004 resulting from the loss of “hedge accounting”.

*** 2003 includes the ineffective portion of fair market value changes under “hedge accounting”.

[Table of Contents](#)

Fuel hedge positions entered into by Alaska and Horizon are currently as follows:

| | Approximate % of Expected Fuel Requirements | Gallons Hedged (in millions) | Approximate Crude Oil Price per Barrel |
|---------------------|---|---------------------------------|---|
| Fourth Quarter 2004 | 50% | 49.0 | \$ 30.39 |
| First Quarter 2005 | 50% | 49.3 | \$ 29.86 |
| Second Quarter 2005 | 50% | 51.9 | \$ 28.97 |
| Third Quarter 2005 | 50% | 55.7 | \$ 28.81 |
| Fourth Quarter 2005 | 50% | 50.4 | \$ 31.85 |
| First Quarter 2006 | 40% | 40.7 | \$ 33.22 |
| Second Quarter 2006 | 30% | 32.1 | \$ 34.41 |
| Third Quarter 2006 | 20% | 22.9 | \$ 36.05 |
| Fourth Quarter 2006 | 10% | 10.4 | \$ 37.28 |
| First Quarter 2007 | 5% | 5.2 | \$ 35.75 |
| Second Quarter 2007 | 5% | 5.5 | \$ 35.48 |
| Third Quarter 2007 | 5% | 5.9 | \$ 35.23 |

As of December 31, 2003 and September 30, 2004, the fair values of the Company's fuel hedge positions were \$18.4 million and \$117.0 million, respectively, and are presented in the consolidated balance sheets as follows (in millions):

| | December 31, 2003 | September 30, 2004 |
|---|-------------------|--------------------|
| Prepaid expenses and other current assets | \$ 12.0 | \$ 81.6 |
| Other assets | 6.4 | 35.4 |
| | <u>\$ 18.4</u> | <u>\$ 117.0</u> |

Note 5. Other Assets

At December 31, 2003 and September 30, 2004, other assets consisted of the following (in millions):

| | December 31, 2003 | September 30, 2004 |
|--|-------------------|--------------------|
| Restricted deposits (primarily restricted investments) | \$ 70.8 | \$ 80.8 |
| Derivative financial instruments (fuel hedges) | 6.4 | 35.4 |
| Deferred costs and other | 27.7 | 34.5 |
| Restricted cash for senior convertible notes | 11.2 | 5.5 |
| | <u>\$ 116.1</u> | <u>\$ 156.2</u> |

Note 6. Frequent Flyer Program

Alaska's Mileage Plan liabilities are included under the following balance sheet captions (in millions):

| | December 31, 2003 | September 30, 2004 |
|--|-------------------|--------------------|
| Current Liabilities: | | |
| Other accrued liabilities | \$ 112.9 | \$ 121.1 |
| Other Liabilities and Credits (non-current): | | |
| Deferred revenue | 204.5 | 238.4 |
| Other liabilities | 18.6 | 19.7 |
| Total | <u>\$ 336.0</u> | <u>\$ 379.2</u> |

Note 7. Employee Benefit Plans
Pension Plans-Defined Benefit

Net pension expense for the three and nine months ended September 30 included the following components (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|-------------------------------------|----------------|------------------------------------|----------------|
| | 2003 | 2004 | 2003 | 2004 |
| Service cost | \$ 11.1 | \$ 13.5 | \$ 33.3 | \$ 40.9 |
| Interest cost | 10.8 | 11.8 | 32.4 | 35.8 |
| Expected return on assets | (8.5) | (10.9) | (25.5) | (32.3) |
| Amortization of prior service cost | 1.3 | 1.1 | 3.9 | 3.7 |
| Actuarial loss | 3.7 | 3.6 | 11.1 | 11.0 |
| SFAS No. 88 curtailment charge* | — | 1.0 | — | 1.0 |
| Net pension expense | <u>\$ 18.4</u> | <u>\$ 20.1</u> | <u>\$ 55.2</u> | <u>\$ 60.1</u> |

* In connection with the restructuring charge and reduction in force as discussed in Note 2, the Company recorded a curtailment charge pursuant to SFAS No. 88. This charge is estimated at \$1.0 million and is included in restructuring charges in the the condensed consolidated financial statements.

The Company made \$37.8 million in contributions to its defined benefit pension plans during the three and nine months ended September 30, 2003. The Company made \$16.5 million and \$49.4 million in contributions during the three and nine months ended September 30, 2004, respectively, and does not expect to make any additional contributions to these plans during the remainder of 2004.

[Table of Contents](#)

Pension Plans-Noncontributory

Net pension expense for the unfunded, noncontributory defined benefit plans for certain elected officers of the Company for the three and nine months ended September 30 included the following components (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2003 | 2004 | 2003 | 2004 |
| Service cost | \$ 0.2 | \$ 0.2 | \$ 0.6 | \$ 0.8 |
| Interest cost | 0.5 | 0.4 | 1.5 | 1.4 |
| Actuarial loss | 0.1 | 0.1 | 0.3 | 0.5 |
| Net pension expense | \$ 0.8 | \$ 0.7 | \$ 2.4 | \$ 2.7 |

Other Postretirement Benefits

Net periodic benefit cost for the postretirement medical plans for the three and nine months ended September 30 included the following components (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2003 | 2004 | 2003 | 2004 |
| Service cost | \$ 0.9 | \$ 0.6 | \$ 2.7 | \$ 3.0 |
| Interest cost | 1.1 | 0.7 | 3.3 | 3.3 |
| Amortization of prior service cost | — | (0.1) | — | (0.3) |
| Actuarial loss | 0.4 | 0.4 | 1.2 | 1.8 |
| Net periodic benefit cost | \$ 2.4 | \$ 1.6 | \$ 7.2 | \$ 7.8 |

Note 8. Earnings Per Share

Earnings per share calculations were as follows (in millions except per share amounts). Stock options are included in the computation of diluted loss per share unless their impact is antidilutive. For the three months ended September 30, 2003 and 2004, options to purchase 2.4 million shares and 3.3 million shares of common stock, respectively, were excluded from the calculations. For the nine months ended September 30, 2003 and 2004, options to purchase 3.1 million shares and 3.2 million shares of common stock, respectively, were excluded from the calculations.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Basic | | | | |
| Net income | \$ 40.7 | \$ 79.2 | \$ 29.6 | \$ 34.8 |
| Weighted average shares outstanding | 26.660 | 26.862 | 26.621 | 26.820 |
| Earnings per share | \$ 1.53 | \$ 2.95 | \$ 1.11 | \$ 1.30 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Diluted | | | | |
| Net income | \$ 40.7 | \$ 79.2 | \$ 29.6 | \$ 34.8 |
| Weighted average shares outstanding | 26.660 | 26.862 | 26.621 | 26.820 |
| Assumed exercise of stock options | .136 | .070 | .059 | .102 |
| Diluted EPS shares | 26.796 | 26.932 | 26.680 | 26.922 |
| Earnings per share | \$ 1.52 | \$ 2.94 | \$ 1.11 | \$ 1.29 |

Diluted shares also excludes the shares of common stock issuable upon conversion of the Company's floating rate senior convertible notes due in 2023 (the Notes) issued on March 21, 2003, because the closing prices of Air Group's common stock during the first, second and third quarters of 2003 and 2004 did not trigger the convertibility feature, their effect would have been antidilutive. Holders may not surrender the notes for conversion into shares of the Company's common stock (or cash, at the election of the Company) unless the closing sale price of the Company's common stock exceeds 110% of the accreted conversion price under the Notes for 20 days in the 30 trading-day period ending on the last day of the fiscal quarter. In addition, holders may require the Company to purchase all or a portion of their Notes, for a purchase price equal to principal plus accrued interest, on the 5th, 10th and 15th anniversaries of the issuance of the Notes, or upon the occurrence of a change of control or tax event. On September 30, 2004, we entered into the First Supplemental Indenture with respect to the Notes to rescind the Company's right to pay for such a repurchase of the Notes at the option of the holders, in whole or in part, in shares of our common stock. Pursuant to the terms of the notes, as amended, any such repurchases shall be paid for in cash.

The Company may redeem all or a portion of the Notes in cash at any time on or after the third anniversary of the issuance of the Notes or if holders of the Notes require the Company to purchase the Notes.

For each \$1,000 of original principal amount per Note, the conversion price through March 21, 2008 is equal to the original principal amount of the Notes, divided by 38.4615. At the date of issuance, the conversion price was equal to \$26.00 per share and the conversion trigger price was equal to 110% of the conversion price, or \$28.60 per share. After March 21, 2008, the conversion price and conversion trigger price increase based on the variable yield of the notes. Once the closing sale price of the Company's common stock exceeds the conversion trigger price for the requisite period, the notes will be convertible at any time thereafter at the option of the holder, through maturity.

During the third quarter of 2004, the Emerging Issues Task Force (EITF) affirmed its tentative conclusion reached in July of 2004 on EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted EPS" (EITF 04-08). EITF 04-08 requires companies to include certain contingently convertible securities in the calculation of diluted EPS to the extent the inclusion of the shares would be dilutive. Adoption of EITF 04-08 is expected to be required during the fourth quarter of 2004 and will impact periods and comparative periods on a go forward basis. Because the Company's convertible notes fall under the scope of EITF 04-08, beginning in the fourth quarter of 2004 and for all comparative periods presented, the Company expects to report a lower

[Table of Contents](#)

lower diluted EPS to the extent the convertible notes are not anti-dilutive. Had EITF 04-08 been required during the third quarter of 2003 and 2004, diluted EPS would include an additional 5.7 million shares and would have resulted in diluted EPS of \$1.29 and \$2.47 for the three months ended September 30, 2003 and 2004, respectively, and \$1.00 and \$1.20 per share for the nine months ended September 30, 2003 and 2004, respectively.

Note 9. Operating Segment Information

Operating segment information for Alaska and Horizon for the three and nine month periods ended September 30 was as follows (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
| | 2003 | 2004 | 2003 | 2004 |
| Operating revenues: | | | | |
| Alaska | \$ 585.3 | \$ 641.2 | \$ 1,522.9 | \$1,710.1 |
| Horizon | 132.7 | 139.3 | 342.3 | 374.3 |
| Elimination of intercompany revenues | (15.8) | (6.7) | (33.7) | (13.5) |
| Consolidated | \$ 702.2 | \$ 773.8 | \$ 1,831.5 | \$2,070.9 |
| Income (loss) before income tax: | | | | |
| Alaska | \$ 50.1 | \$ 106.3 | \$ 39.1 | \$ 50.3 |
| Horizon | 19.5 | 24.4 | 19.9 | 18.7 |
| Other* | (1.4) | (3.1) | (5.9) | (8.3) |
| Consolidated | \$ 68.2 | \$ 127.6 | \$ 53.1 | \$ 60.7 |
| Total assets at end of period: | | | | |
| Alaska | | | \$ 3,072.7 | \$3,158.7 |
| Horizon | | | 257.4 | 304.1 |
| Other* | | | 911.1 | 887.4 |
| Elimination of intercompany accounts | | | (1,001.8) | (941.1) |
| Consolidated | | | \$ 3,239.4 | \$3,409.1 |

* Includes the parent company, Alaska Air Group, Inc, including Alaska Air Group Leasing and investments in Alaska and Horizon, which are eliminated in consolidation.

Note 10. Long-Term Debt and Capital Lease Obligations

At December 31, 2003, and September 30, 2004, long-term debt and capital lease obligations were as follows (in millions):

| | December 31, 2003 | September 30, 2004 |
|--|-------------------|--------------------|
| Fixed rate notes payable due through 2015 | \$ 382.6 | \$ 368.6 |
| Variable rate notes payable due through 2018 | 572.5 | 540.6 |
| Senior convertible notes due through 2023 | 150.0 | 150.0 |
| Long-term debt | 1,105.1 | 1,059.2 |
| Capital lease obligations | 8.5 | 0.5 |
| Less current portion | (206.7) | (52.1) |
| | \$ 906.9 | \$ 1,007.6 |

During the first nine months of 2004, Alaska issued \$94.6 million of debt secured by flight equipment, having interest rates that vary with LIBOR and payment terms ranging from 12 to 16 years. Debt issuances during the period were offset by normal long-term debt payments of \$43.2 million and full repayment of the Company's credit facility of \$150.0 million.

During the first nine months of 2004, Horizon financed three Bombardier Q400s under long-term debt arrangements totaling \$44.7 million. These debt arrangements have a 15-year term and interest rates that vary with LIBOR. Two of the aircraft were originally leased in January 2004 and were treated as capital leases at that time. The resulting re-financing transactions did not result in any gain or loss in the consolidated statements of operations.

Note 11. Contingencies

The Company is a party to routine litigation incidental to its business and with respect to which no material liability is expected. Management believes the ultimate disposition of these matters is not likely to materially affect the Company's financial position or results of operations. However, this belief is based on management's current understanding of the relevant law and facts; it is subject to various contingencies, including the potential costs and risks associated with litigation and the actions of judges and juries.

Note 12. U.S. Government Compensation

On April 16, 2003, the Emergency Wartime Supplemental Appropriations Act (the Act) was signed into legislation. The Act included \$2.3 billion of one-time cash payments to air carriers, allocated based on each carrier's share of security fees remitted and carrier fees paid to the Transportation Security Administration (TSA) since its inception in February 2002. In May 2003, the Company received its share of the one-time cash grant in the amount of \$71.4 million (\$52.8 million for Alaska and \$18.6 million for Horizon).

Note 13. Revision of Previously Issued Financial Statements

In its previously reported 2003 Form 10-Q's, the Company recorded unrealized gains and losses related to the ineffective portion of changes in fair value of our fuel hedge positions as nonoperating income (expense) and then reclassified those gains and losses to fuel expense as those hedges were settled. This practice was not consistent with its stated policy, which is to record the ineffective portion in nonoperating income (expense). The Company has revised its 2003 reported condensed consolidated financial statements to adjust its historical presentation of such items. Such revisions have resulted in reclassification between operating income (loss) and nonoperating income (expense) in the condensed consolidated statements of operations. The revisions have no impact on previously reported pretax income, net income, earnings per share, the condensed consolidated balance sheets, the condensed consolidated statements of shareholders' equity or the condensed consolidated statements of cash flows for any periods.

The effect of the revisions for 2003 is as follows (in millions):

| | Three Months Ended September 30, 2003 | Nine Months Ended September 30, 2003 |
|--------------------------------|--|---|
| Total Aircraft Fuel: | | |
| As Previously Reported | \$ 94.7 | \$ 265.0 |
| As Revised | \$ 96.8 | \$ 270.5 |
| Total Operating Expenses: | | |
| As Previously Reported | \$ 623.4 | \$ 1,827.3 |
| As Revised | \$ 625.5 | \$ 1,832.8 |
| Total Operating Income (Loss): | | |
| As Previously Reported | \$ 78.8 | \$ 4.2 |
| As Revised | \$ 76.7 | \$ (1.3) |
| Nonoperating income (expense): | | |
| As Previously Reported | \$ (10.6) | \$ 48.9 |
| As Revised | \$ (8.5) | \$ 54.4 |

Alaska Airlines Financial and Statistical Data

| Financial Data (in millions): | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|--|---------------------------------|----------|----------|--------------------------------|-----------|----------|
| | 2003 | 2004 | % Change | 2003 | 2004 | % Change |
| Operating Revenues: | | | | | | |
| Passenger | \$ 532.5 | \$ 576.6 | 8.3% | \$1,380.1 | \$1,545.8 | 12.0% |
| Freight and mail | 21.4 | 24.5 | 14.5% | 59.8 | 65.3 | 9.2% |
| Other — net | 31.4 | 40.1 | 27.7% | 83.0 | 99.0 | 19.3% |
| Total Operating Revenues | 585.3 | 641.2 | 9.6% | 1,522.9 | 1,710.1 | 12.3% |
| Operating Expenses: | | | | | | |
| Wages and benefits | 198.7 | 207.3 | 4.3% | 578.7 | 611.8 | 5.7% |
| Contracted services | 20.5 | 17.8 | -13.2% | 60.9 | 70.3 | 15.4% |
| Aircraft fuel | 83.3 | 130.2 | 56.3% | 232.2 | 336.4 | 44.9% |
| Aircraft maintenance | 35.2 | 27.1 | -23.0% | 117.7 | 111.3 | -5.4% |
| Aircraft rent | 31.1 | 28.1 | -9.6% | 92.8 | 85.5 | -7.9% |
| Food and beverage service | 17.0 | 13.7 | -19.4% | 44.8 | 37.9 | -15.4% |
| Other selling expenses and commissions | 43.4 | 35.9 | -17.3% | 109.0 | 101.1 | -7.2% |
| Depreciation and amortization | 29.7 | 32.0 | 7.7% | 87.8 | 95.2 | 8.4% |
| Loss on sale of assets | 0.8 | (2.5) | NM | 1.3 | (0.6) | NM |
| Landing fees and other rentals | 33.6 | 37.6 | 11.9% | 93.5 | 106.1 | 13.5% |
| Other | 34.5 | 37.1 | 7.5% | 102.9 | 111.0 | 7.9% |
| Restructuring charges | — | 27.5 | 100.0% | — | 27.5 | NM |
| Impairment of aircraft | — | — | 0.0% | — | 36.8 | NM |
| Total Operating Expenses | 527.8 | 591.8 | 12.1% | 1,521.6 | 1,730.3 | 13.7% |
| Operating Income (Loss) | 57.5 | 49.4 | -14.1% | 1.3 | (20.2) | NM |
| Interest income | 4.6 | 8.4 | | 10.3 | 20.0 | |
| Interest expense | (11.2) | (11.6) | | (33.9) | (33.1) | |
| Interest capitalized | 0.2 | 0.4 | | 1.3 | 0.7 | |
| U.S. government compensation | — | — | | 52.8 | — | |
| Other — net | (1.0) | 59.7 | | 7.3 | 82.9 | |
| | (7.4) | 56.9 | | 37.8 | 70.5 | |
| Income Before Income Tax | \$ 50.1 | \$ 106.3 | 112.2% | \$ 39.1 | \$ 50.3 | 28.7% |
| Operating Statistics: | | | | | | |
| Revenue passengers (000) | 4,280 | 4,589 | 7.2% | 11,335 | 12,296 | 8.5% |
| RPMs (000,000) | 4,126 | 4,571 | 10.8% | 10,946 | 12,255 | 12.0% |
| ASMs (000,000) | 5,693 | 6,012 | 5.6% | 15,611 | 16,825 | 7.8% |
| Passenger load factor | 72.5% | 76.0% | 3.5 pts | 70.1% | 72.8% | 2.7 pts |
| Yield per passenger mile | 12.91¢ | 12.62¢ | -2.2% | 12.61¢ | 12.61¢ | 0.0% |
| Operating revenue per ASM | 10.28¢ | 10.66¢ | 3.7% | 9.76¢ | 10.16¢ | 4.1% |
| Operating expenses per ASM (a) | 9.27¢ | 9.84¢ | 6.1% | 9.75¢ | 10.28¢ | 5.4% |
| Operating expenses per ASM excluding fuel, navigation fee settlement, restructuring and impairment charges (a) | 7.81¢ | 7.35¢ | -6.0% | 8.26¢ | 7.95¢ | -3.9% |
| Raw fuel cost per gallon (a) | 95.2¢ | 139.6¢ | 46.6% | 97.0¢ | 129.8¢ | 33.8% |
| GAAP fuel cost per gallon (a) | 90.5¢ | 135.9¢ | 50.2% | 91.5¢ | 125.7¢ | 37.4% |
| Economic fuel cost per gallon (a) | 88.7¢ | 127.0¢ | 43.2% | 89.6¢ | 121.3¢ | 35.4% |
| Fuel gallons (000,000) | 92.0 | 95.8 | 4.1% | 253.9 | 267.6 | 5.4% |
| Average number of employees | 10,114 | 10,201 | 0.9% | 10,079 | 10,147 | 0.7% |
| Aircraft utilization (blk hrs/day) | 11.1 | 11.8 | 6.3% | 10.6 | 11.1 | 4.7% |
| Operating fleet at period-end | 109 | 107 | -1.8% | 109 | 107 | -1.8% |

NM = Not Meaningful

(a) See Note A on Page 21

Horizon Air Financial and Statistical Data

| Financial Data (in millions): | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|--|---------------------------------|----------|----------|--------------------------------|---------|----------|
| | 2003 | 2004 | % Change | 2003 | 2004 | % Change |
| Operating Revenues: | | | | | | |
| Passenger | \$ 127.2 | \$ 134.5 | 5.7% | \$326.8 | \$360.4 | 10.3% |
| Freight and mail | 1.2 | 1.0 | -16.7% | 3.8 | 3.0 | -20.9% |
| Other — net | 4.3 | 3.8 | -11.6% | 11.7 | 10.9 | -6.8% |
| Total Operating Revenues | 132.7 | 139.3 | 5.0% | 342.3 | 374.3 | 9.3% |
| Operating Expenses: | | | | | | |
| Wages and benefits | 39.2 | 39.7 | 1.3% | 118.8 | 122.1 | 2.8% |
| Contracted services | 5.7 | 5.0 | -12.3% | 18.4 | 15.4 | -16.3% |
| Aircraft fuel | 13.5 | 18.2 | 34.8% | 38.3 | 48.4 | 26.4% |
| Aircraft maintenance | 7.2 | 9.9 | 37.5% | 22.5 | 26.6 | 18.2% |
| Aircraft rent | 18.1 | 18.6 | 2.8% | 53.3 | 56.0 | 5.1% |
| Food and beverage service | 0.6 | 0.6 | 0.0% | 1.8 | 1.6 | -11.1% |
| Other selling expenses and commissions | 6.6 | 6.7 | 1.5% | 18.8 | 19.9 | 5.9% |
| Depreciation and amortization | 2.7 | 3.4 | 25.9% | 9.5 | 9.7 | 2.1% |
| Gain on sale of assets | (0.7) | (0.3) | NM | (1.1) | (0.8) | NM |
| Landing fees and other rentals | 10.3 | 11.0 | 6.8% | 28.2 | 31.2 | 10.6% |
| Other | 9.7 | 9.7 | 0.0% | 32.6 | 32.0 | -1.8% |
| Impairment of aircraft and spare engines | — | — | 0.0% | — | 2.8 | NM |
| Total Operating Expenses | 112.9 | 122.5 | 8.5% | 341.1 | 364.9 | 7.0% |
| Operating Income | 19.8 | 16.8 | -15.2% | 1.2 | 9.4 | NM |
| Interest income | 0.2 | 0.3 | | 0.5 | 0.9 | |
| Interest expense | (0.6) | (0.9) | | (1.9) | (3.2) | |
| Interest capitalized | 0.2 | 0.1 | | 0.6 | 0.4 | |
| Government compensation | — | — | | 18.6 | — | |
| Other — net | (0.1) | 8.1 | | 0.9 | 11.2 | |
| | (0.3) | 7.6 | | 18.7 | 9.3 | |
| Income Before Income Tax | \$ 19.5 | \$ 24.4 | 25.1% | \$ 19.9 | \$ 18.7 | -5.9% |
| Operating Statistics: | | | | | | |
| Revenue passengers (000) | 1,376 | 1,641 | 19.3% | 3,671 | 4,362 | 18.8% |
| RPMs (000,000) | 466 | 601 | 29.0% | 1,224 | 1,586 | 29.6% |
| ASMs (000,000) | 701 | 830 | 18.4% | 1,950 | 2,314 | 18.7% |
| Passenger load factor | 66.5% | 72.4% | 5.9 pts | 62.8% | 68.5% | 5.7 pts |
| Yield per passenger mile | 27.29¢ | 22.38¢ | -18.0% | 26.70¢ | 22.73¢ | -14.9% |
| Operating revenue per ASM | 18.93¢ | 16.78¢ | -11.4% | 17.56¢ | 16.18¢ | -7.9% |
| Operating expenses per ASM (a) | 16.11¢ | 14.76¢ | -8.4% | 17.49¢ | 15.77¢ | -10.0% |
| Operating expenses per ASM excluding fuel and impairment charges (a) | 14.18¢ | 12.57¢ | -11.4% | 15.53¢ | 13.56¢ | -12.7% |
| Raw fuel cost per gallon (a) | 98.6¢ | 143.8¢ | 46.0% | 100.2¢ | 134.1¢ | 33.8% |
| GAAP fuel cost per gallon (a) | 93.1¢ | 140.0¢ | 50.4% | 94.1¢ | 130.1¢ | 38.3% |
| Economic fuel cost per gallon (a) | 90.3¢ | 131.2¢ | 45.2% | 91.9¢ | 125.8¢ | 36.8% |
| Fuel gallons (000,000) | 14.5 | 13.0 | -10.3% | 40.7 | 37.2 | -8.6% |
| Average number of employees | 3,368 | 3,439 | 2.1% | 3,375 | 3,399 | 0.7% |
| Aircraft utilization (blk hrs/day) | 8.2 | 8.7 | 6.1% | 7.9 | 8.3 | 5.1% |
| Operating fleet at period-end | 61 | 65 | 6.6% | 61 | 65 | 6.6% |

NM = Not Meaningful

(a) See Note A on Page 21

Note A:

Pursuant to Item 10 of Regulation S-K, we are providing disclosure of the reconciliation of reported non-GAAP financial measures to their most directly comparable financial measures reported on a GAAP basis. The non-GAAP financial measures provide management the ability to measure and monitor performance both with and without the cost of aircraft fuel (including the gains and losses associated with our fuel hedging program where appropriate), restructuring charges, aircraft impairment charges, government compensation in 2003 and a large recovery in 2004 of disputed navigation fees paid in prior years (of which \$7.7 million was recorded in operating expenses and \$3.3 million was recorded in non-operating income). Because the cost and availability of aircraft fuel are subject to many economic and political factors beyond our control and we record changes in the fair value of our hedge portfolio in our income statement, it is our view that the measurement and monitoring of performance without fuel is important. In addition, we believe the disclosure of financial performance without impairment and restructuring charges, government compensation and the navigation fee recovery in 2004 is useful to investors. Finally, these non-GAAP financial measures are also more comparable to financial measures reported to the Department of Transportation by other major network airlines. The following tables reconcile our non-GAAP financial measures to the most directly comparable GAAP financial measures for both Alaska Airlines, Inc. and Horizon Air Industries, Inc.:

Alaska Airlines, Inc.:

| (\$ in millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|----------|---------------------------------|------------|
| | 2003 | 2004 | 2003 | 2004 |
| Unit cost reconciliations: | | | | |
| Operating expenses | \$ 527.8 | \$ 591.8 | \$ 1,521.6 | \$ 1,730.3 |
| ASMs (000,000) | 5,693 | 6,012 | 15,611 | 16,825 |
| Operating expenses per ASM | 9.27¢ | 9.84¢ | 9.75¢ | 10.28¢ |
| Operating expenses | \$ 527.8 | \$ 591.8 | \$ 1,521.6 | \$ 1,730.3 |
| Less: aircraft fuel | (83.3) | (130.2) | (232.2) | (336.4) |
| Less: impairment of aircraft | — | — | — | (36.8) |
| Less: restructuring charges | — | (27.5) | — | (27.5) |
| Add: navigation fee settlement | — | 7.7 | — | 7.7 |
| Operating expense excluding fuel, navigation fee settlement, impairment and restructuring charges | \$ 444.5 | \$ 441.8 | \$ 1,289.4 | \$ 1,337.3 |
| ASMs (000,000) | 5,693 | 6,012 | 15,611 | 16,825 |
| Operating expense per ASM excluding fuel, navigation fee settlement, impairment and restructuring charges | 7.81¢ | 7.35¢ | 8.26¢ | 7.95¢ |
| Aircraft fuel reconciliations: | | | | |
| Fuel expense before hedge activities ("raw fuel") | \$ 87.6 | \$ 133.7 | \$ 246.2 | \$ 347.4 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| Raw fuel cost per gallon | 95.2¢ | 139.6¢ | 97.0¢ | 129.8¢ |
| Fuel expense before hedge activities ("raw fuel") | \$ 87.6 | \$ 133.7 | \$ 246.2 | \$ 347.4 |
| Less: gains on settled hedges included in fuel expense | (4.3) | (3.5) | (14.0) | (11.0) |
| GAAP fuel expense | \$ 83.3 | \$ 130.2 | \$ 232.2 | \$ 336.4 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| GAAP fuel cost per gallon | 90.5¢ | 135.9¢ | 91.5¢ | 125.7¢ |
| GAAP fuel expense | \$ 83.3 | \$ 130.2 | \$ 232.2 | \$ 336.4 |
| Less: gains on settled hedges included in nonoperating income (expense) | (1.7) | (8.5) | (4.6) | (11.7) |
| Adjusted fuel | 81.6 | 121.7 | 227.6 | 324.7 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| Economic fuel cost per gallon | 88.7¢ | 127.0¢ | 89.6¢ | 121.3¢ |
| Mark-to-market gains included in non-operating income related to hedges that settle in future periods | — | \$ 50.3 | — | \$ 70.4 |
| Reconciliation to GAAP pretax income (loss): | | | | |
| Pretax income (loss) excluding impairment and restructuring charges, navigation fee settlement, government compensation and mark-to-market hedging gains | \$ 50.1 | \$ 72.5 | (\$13.7) | \$ 33.2 |
| Less: impairment of aircraft | — | — | — | (36.8) |
| Less: restructuring charges | — | (27.5) | — | (27.5) |
| Add: government compensation | — | — | 52.8 | — |
| Add: mark-to-market hedging gains included in nonoperating income (expense) | — | 50.3 | — | 70.4 |
| Add: navigation fee settlement | — | 11.0 | — | 11.0 |
| Pretax income (loss) reported GAAP amounts | \$ 50.1 | \$ 106.3 | \$ 39.1 | \$ 50.3 |

Horizon Air Industries, Inc.

| (\$ in millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|----------|---------------------------------|----------|
| | 2003 | 2004 | 2003 | 2004 |
| Unit cost reconciliations: | | | | |
| Operating expenses | \$ 112.9 | \$ 122.5 | \$ 341.1 | \$ 364.9 |
| ASMs (000,000) | 701 | 830 | 1,950 | 2,314 |
| Operating expenses per ASM | 16.11¢ | 14.76¢ | 17.49¢ | 15.77¢ |
| Operating expenses | \$ 112.9 | \$ 122.5 | \$ 341.1 | \$ 364.9 |
| Less: aircraft fuel | (13.5) | (18.2) | (38.3) | (48.4) |
| Less: impairment of aircraft | — | — | — | (2.8) |
| Operating expense excluding fuel and impairment charge | \$ 99.4 | \$ 104.3 | \$ 302.8 | \$ 313.7 |
| ASMs (000,000) | 701 | 830 | 1,950 | 2,314 |
| Operating expense per ASM excluding fuel and impairment charge | 14.18¢ | 12.57¢ | 15.53¢ | 13.56¢ |
| Aircraft fuel reconciliations: | | | | |
| Fuel expense before hedge activities ("raw fuel") | \$ 14.3 | \$ 18.7 | \$ 40.8 | \$ 49.9 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| Raw fuel cost per gallon | 98.6¢ | 143.8¢ | 100.2¢ | 134.1¢ |
| Fuel expense before hedge activities ("raw fuel") | \$ 14.3 | \$ 18.7 | \$ 40.8 | \$ 49.9 |
| Less: gains on settled hedges included in fuel expense | (0.8) | (0.5) | (2.5) | (1.5) |
| GAAP fuel expense | \$ 13.5 | \$ 18.2 | \$ 38.3 | \$ 48.4 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| GAAP fuel cost per gallon | 93.1¢ | 140.0¢ | 94.1¢ | 130.1¢ |
| GAAP fuel expense | \$ 13.5 | \$ 18.2 | \$ 38.3 | \$ 48.4 |
| Less: gains on settled hedges included in nonoperating income (expense) | (0.3) | (1.2) | (0.8) | (1.6) |
| Adjusted fuel | 13.2 | 17.0 | 37.5 | 46.8 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| Economic fuel cost per gallon | 90.3¢ | 131.2¢ | 91.9¢ | 125.8¢ |
| Mark-to-market gains (losses) included in non-operating income related to hedges that settle in future periods | — | \$ 6.9 | — | \$ 9.6 |
| Reconciliation to GAAP pretax income (loss): | | | | |
| Pretax income (loss) excluding impairment charge, government compensation and mark-to-market hedging gains | \$ 19.5 | \$ 17.5 | \$ 1.3 | \$ 11.9 |
| Less: impairment of aircraft and related spare parts | — | — | — | (2.8) |
| Add: government compensation | — | — | 18.6 | — |
| Add: mark-to-market hedging gains included in nonoperating income (expense) | — | 6.9 | — | 9.6 |
| Pretax income (loss) reported GAAP amounts | \$ 19.5 | \$ 24.4 | \$ 19.9 | \$ 18.7 |

Air Group Net Income and EPS Reconciliation:

The following table summarizes Alaska Air Group, Inc.'s net income and diluted earnings per share during 2003 and 2004 excluding restructuring and impairment charges, navigation fee recovery, the second and third quarter of 2004 hedging mark-to-market gains, government compensation and as reported in accordance with GAAP (in millions except per share amounts):

| | Three Months Ended September 30, | | | |
|--|----------------------------------|-------------|---------|-------------|
| | 2003 | | 2004 | |
| | Dollars | Diluted EPS | Dollars | Diluted EPS |
| Net income and diluted EPS excluding mark-to-market hedging gains, navigation fee settlement and restructuring charges | \$ 40.7 | \$ 1.52 | \$ 55.9 | \$ 2.08 |
| Mark-to-market hedging gains, net of tax | — | — | 32.8 | 1.22 |
| Navigation fee settlement | — | — | 6.3 | 0.23 |
| Restructuring charge, net of tax | — | — | (15.8) | (0.59) |
| Reported GAAP amounts | \$ 40.7 | \$ 1.52 | \$ 79.2 | \$ 2.94 |

| | Nine Months Ended September 30, | | | |
|---|---------------------------------|-------------|---------|-------------|
| | 2003 | | 2004 | |
| | Dollars | Diluted EPS | Dollars | Diluted EPS |
| Net income (loss) and diluted EPS excluding mark-to-market hedging gains, navigation fee settlement, restructuring charges, government compensation and impairment charge | (\$ 14.7) | (\$ 0.55) | \$ 24.7 | \$ 0.92 |
| Government compensation, net of tax | 44.3 | 1.66 | — | — |
| Navigation fee settlement | — | — | 6.3 | 0.23 |
| Mark-to-market hedging gains, net of tax | — | — | 45.9 | 1.71 |
| Impairment charge, net of tax | — | — | (26.3) | (0.98) |
| Restructuring charge, net of tax | — | — | (15.8) | (0.59) |
| Reported GAAP amounts | \$ 29.6 | \$ 1.11 | \$ 34.8 | \$ 1.29 |

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes contained elsewhere in this quarterly report on Form 10-Q. All statements in the following discussion that are not reports of historical information or descriptions of current accounting policy are forward-looking statements. Please consider our forward-looking statements in light of the risks referred to in this report's introductory cautionary note.

Air Group's filings with the Securities and Exchange Commission, including its annual report on Form 10-K/A, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are accessible free of charge at www.alaskaair.com. The information contained on our website is not a part of this quarterly report on Form 10-Q. As used in this Form 10-Q, the terms "Air Group," "our," "we" and the "Company" refer to Alaska Air Group, Inc. and its subsidiaries, unless the context indicates otherwise.

Third Quarter in Review and Current Events

We recorded a third quarter 2004 net income of \$79.2 million, or \$2.94 per diluted share, compared to \$40.7 million, or \$1.52 per diluted share, in the third quarter of 2003. Third quarter results include a restructuring charge of \$27.5 million (\$15.8 million net of tax, or \$0.59 per share) related to the restructuring initiatives announced in late August and early September. Third quarter results also include mark-to-market fuel hedging gains, reflecting the increase in the fair value of our hedge portfolio during the quarter, of \$57.2 million (\$32.8 million net of tax, or \$1.22 per share). These amounts are net of the gains realized on contracts which settled during the quarter. Finally, third quarter results include the recovery of certain disputed Mexico navigation fees which were originally paid in 2002 and 2003, that amounted to \$11.0 million (\$6.3 million net of tax, or \$0.23 per share). Approximately \$7.7 million of this refund was recorded in operating expenses for fees previously remitted and the remaining \$3.3 million was recorded in non-operating income for interest accrued on the fees. Without these items in 2004, net income would have been \$55.9 million, or \$2.08 per share during 2004. Financial and statistical data comparisons for Alaska and Horizon are shown on pages 20 and 21, respectively. A discussion of the three-month data follows. On pages 22 through 24, we have included a reconciliation of reported non-GAAP financial measures to the most directly comparable GAAP financial measures.

Restructuring Charges

During the third quarter of 2004, the Company announced a management reorganization and the closure of its Oakland maintenance base, contracting out of the Company's Fleet Service, Ground Equipment and Facility maintenance functions and other initiatives. In total, these restructuring activities are expected to result in a reduction of approximately 900 employees when fully implemented in 2005. Severance and related costs associated with this restructuring are estimated at \$50-\$55 million, of which \$27.5 million was recorded during the third quarter of 2004 and \$23-\$27 million will be recorded in the fourth quarter. The Company is also currently evaluating any possible asset impairment that may result from the announced initiatives. Any impairment charge would be in addition to the severance estimates above. We expect savings from these job-related initiatives to be approximately \$35 million per year when fully implemented.

[Table of Contents](#)

Labor Costs and Negotiations

Alaska Airlines continues to pursue the restructuring of its labor agreements so that they are in line with the market. Our objectives as we restructure these agreements are to achieve market labor costs, productivity and employee benefit costs. Based on these three objectives, in 2003 Alaska targeted \$112 million per year of labor savings. As a result of increases in our wage rates since that time combined with labor cost decreases achieved by our competitors, we believe that our wages and benefits are now above market by more than \$112 million. Alaska believes that its pilot labor costs represent the majority of this amount. Alaska is currently in negotiations with the Air Line Pilots Association (ALPA) on the pilot collective bargaining agreement. If we do not reach an agreement, the parties will submit the contract to binding arbitration, the decision of which will be effective in May 2005. The arbitration will cover wages plus five issues submitted by each of the Company and ALPA. The pilot labor contract contains market related standards for wages and benefits. Nevertheless, we cannot predict the outcome of this proceeding, particularly whether the arbitrator's award will reflect cost savings in wage rates, productivity and benefits equal to what we consider to be the current excess over market.

Mark-to-Market Fuel Hedging Gains

Beginning in the second quarter of 2004, we lost the ability to defer, as a component of comprehensive income, recognition of any unrealized gain or loss on our fuel hedge contracts until the hedged fuel is consumed. We lost this ability because the correlation between crude oil, the commodity we use to hedge, and West Coast jet fuel fell below required thresholds. For more discussion, see Note 4 to our condensed consolidated financial statements.

The implications of this change in the current period and on a go-forward basis are twofold: First, we will have more volatile earnings as we mark our entire hedge portfolio to market each quarter-end and report the gain or loss in other non-operating income or expense. Second, to an increasing extent, the impact of our fuel hedge program will not be reflected in fuel expense. We had unrealized gains on our balance sheet of \$26.5 million at March 31, 2004 when we last qualified for hedge accounting. These unrealized gains will be recognized in fuel expense as the hedged fuel is consumed, which will occur through the second quarter of 2006. Subsequent gains or losses resulting from changes in the fair value of our current hedge positions will be recorded in other non-operating income or expense until correlation returns and the positions are redesignated.

We have provided information on mark-to-market gains or losses, as well as calculations of our economic fuel cost per gallon on pages 22 through 24.

We continue to believe that our fuel hedge program is an important part of our strategy to reduce our exposure to volatile fuel prices.

Impairment of 737-200C Aircraft

In June 2004, the Company's Board approved a plan to accelerate the retirement of its Boeing 737-200C fleet and remove those aircraft from service (by the end of 2007) earlier than initially planned. In July 2004, the Company announced its plan to replace these aircraft by modifying five existing 737-400 aircraft and using other existing 737-400 aircraft for the remaining passenger capacity. Four of the five modified airplanes will be converted into combination passenger/cargo aircraft and one will

[Table of Contents](#)

be converted to an all cargo aircraft. The Company expects to backfill the 737-400s with Boeing 737-800 aircraft in 2005 and 2006.

As a result of this decision, the Company evaluated impairment as required by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and concluded that the carrying value of the 737-200C fleet was no longer recoverable when compared to the estimated remaining future cash flows. Accordingly, during the second quarter of 2004, the Company recorded an impairment charge totaling \$36.8 million (pretax) to write down the fleet to its estimated fair market value. In addition, we revised our estimates of the useful lives and residual values of the fleet and related spare equipment and will depreciate the remaining carrying values through 2007, when the last aircraft will be retired.

Other Events

In October 2004, Alaska entered into a 10 year outsourcing "power-by-the-hour" engine maintenance agreement with a third party. Under terms of this arrangement, the third party will provide routine and major overhaul maintenance services on certain engines in our 737-400 fleet at an agreed upon rate per hour flown.

On January 1, 2004, Horizon began operating regional jet service branded as Frontier JetExpress under a 12-year agreement with Frontier Airlines. Service under this agreement became fully operational during the second quarter of 2004 and Horizon is currently operating nine regional jet aircraft under the Frontier JetExpress brand. Flying under this agreement represented 23.1% of Horizon's third quarter capacity and 9.2% of passenger revenues.

The arrangement with Frontier provides for reimbursement of expected costs plus a base mark up and certain incentives. However, since Horizon is not responsible for many of the typical costs of operations such as fuel, landing fees, marketing costs and station labor and rents, revenue per ASM, cost per ASM and cost per ASM excluding fuel for this flying is significantly lower than Horizon's native network flying.

For 2004, Alaska and Horizon expect capacity increases of approximately 7% and 20%, respectively. The expected capacity increase at Alaska is due largely to the annualization of the additional aircraft added in 2003 combined with increases in utilization. Horizon's expected capacity increase is due largely to the annualization of aircraft additions in late 2003, the addition of two aircraft in the first half of 2004, the arrival of a third aircraft in early July 2004 and higher utilization resulting from the new contract flying for Frontier.

Alaska is currently in the process of adding a row of seats to its 737-400 fleet. When complete, this will result in an increase of approximately 2.3% in available seat miles on an annualized basis. We expect this change will represent a significant portion of our capacity growth in 2005.

[Table of Contents](#)

In 2005, Horizon will be adding a row of seats to the Q400 fleet increasing capacity from 70 to 74 seats. When complete, this will result in an increase of approximately 1.5% in available seat miles on an annualized basis.

Results of Operations

Comparison of Three Months Ended September 30, 2004 to Three Months Ended September 30, 2003

During the third quarter of 2004, we recorded consolidated operating and pre-tax income of \$65.2 million and \$127.6 million, respectively, versus \$76.7 million and \$68.2 million, respectively, in the third quarter of 2003.

Alaska Airlines Revenues

Operating revenues increased \$55.9 million, or 9.6%, during 2004 as compared to 2003. For the quarter, available seat miles (ASMs or capacity) increased 5.6% and revenue passenger miles (RPMs or traffic) increased 10.8%. The majority of our 2004 ASM growth came from expansion in our Trans-Continental markets. We also experienced slight increases in capacity in Nevada, Mexico and Anchorage/Fairbanks-Lower 48, partially offset by decreases in service to Northern Alaska, Canada, Arizona, the Bay Area and the Pacific Northwest. Traffic increases primarily reflect increases in traffic in the Trans Continental, Denver, Southern California, Mexico, Arizona, Nevada and Anchorage/Fairbanks-Lower 48 markets, partially offset by decreases in traffic in Northern Alaska, the Bay Area and Canada.

Passenger revenues increased by 8.3% as a result of a 10.8% increase in traffic partially offset by a 2.2% decrease in yield per passenger mile. Load factors were up year over year in all of our regions.

Freight and mail revenues increased by \$3.1 million, or 14.5%, compared to the same period in 2003 as a result of a new mail contract we have in the State of Alaska and due to revenues associated with an agreement with PenAir to provide flight services to Dutch Harbor that began in January of 2004. These increases are partially offset by lower contract maintenance revenue.

Other-net revenues increased \$8.7 million, or 27.7%, due largely to higher cash receipts (and through higher revenue) from the Mileage Plan credit card.

Alaska Airlines Expenses

For the quarter, total operating expenses increased \$64.0 million, or 12.1%, as compared to the same period in 2003. Operating expenses per ASM increased 6.1% in 2004 as compared to 2003. These increases are due largely to the restructuring charge, significant increases in fuel costs and higher wages and benefit costs. Operating expense per ASM excluding fuel, the navigation fee recovery and the restructuring charge decreased 6.0% as compared to the same period in 2003. Explanations of significant period-over-period changes in the components of operating expenses are as follows:

[Table of Contents](#)

- Wages and benefits increased \$8.6 million, or 4.3%, during the third quarter. Approximately \$1.5 million of this increase reflects higher benefit costs, resulting from increases in pension, medical and health insurance costs. The remaining \$7.1 million increase primarily reflects scale and step increases.

In May 2004, under terms of our union contract, our pilots received a 4% wage rate increase, which represented 50.7% of the total increase in wages.

- Contracted services decreased \$2.7 million, or 13.2%, due largely to the recovery in 2004 of disputed Mexico navigation fees paid in 2002 and 2003, partially offset by expenses associated with an agreement with PenAir to provide flight services to Dutch Harbor that began in January of 2004 and costs associated with a temporary charter contract we had for our new mail contract in Alaska, and higher security costs.
- Aircraft fuel increased \$46.9 million, or 56.3%, due to a 50.2% increase in the GAAP fuel cost per gallon and a 4.1% increase in fuel gallons consumed. Our economic cost per gallon (the raw price paid less all benefits from settled hedges) was \$1.27 per gallon, a 43.2% increase over the prior year. Fuel prices remain at very high levels and continue to be volatile. At September 30, 2004, we have fuel hedge contracts in place to hedge 50% of our anticipated fuel consumption for the remainder of 2004 and 2005 and 25% of our anticipated fuel consumption in 2006 at prices ranging from \$28.81 to \$37.28 per crude oil barrel.

[Table of Contents](#)

The following table summarizes fuel cost per gallon realized by Alaska (the economic cost per gallon), the cost per gallon on a GAAP basis (including hedging gains recorded in aircraft fuel and non-operating income (expense)) and fuel cost per gallon excluding all hedging activities:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Fuel expense before hedge activities ("raw fuel") | \$ 87.6 | \$ 133.7 | \$246.2 | \$347.4 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| Raw fuel cost per gallon | 95.2¢ | 139.6¢ | 97.0¢ | 129.8¢ |
| Fuel expense before hedge activities ("raw fuel") | \$ 87.6 | \$ 133.7 | \$246.2 | \$347.4 |
| Less: gains on settled hedges included in fuel expense | (4.3) | (3.5) | (14.0) | (11.0) |
| GAAP fuel expense | \$ 83.3 | \$ 130.2 | \$232.2 | \$336.4 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| GAAP fuel cost per gallon | 90.5¢ | 135.9¢ | 91.5¢ | 125.7¢ |
| GAAP fuel expense | \$ 83.3 | \$ 130.2 | \$232.2 | \$336.4 |
| Less: gains on settled hedges included in nonoperating income (expense) | (1.7) | (8.5) | (4.6) | (11.7) |
| Adjusted fuel | \$ 81.6 | \$ 121.7 | \$227.6 | \$324.7 |
| Fuel gallons (000,000) | 92.0 | 95.8 | 253.9 | 267.6 |
| Economic fuel cost per gallon | 88.7¢ | 127.0¢ | 89.6¢ | 121.3¢ |
| Mark-to-market gains included in nonoperating income related to hedges that settle in future periods (in millions) | — | \$ 50.3 | — | \$ 70.4 |

- Aircraft maintenance decreased \$8.1 million, or 23.0%, due largely to fewer engine overhauls and a change in the mix of heavy maintenance versus routine maintenance.

For the remainder of the year we anticipate that aircraft maintenance will be somewhat higher than in 2003 as outsourcing of all base maintenance work takes effect. The anticipated savings from contracting out will be reflected through lower wages and benefits in future periods.

- Aircraft rent decreased \$3.0 million, or 9.6%, due to lower rates on extended leases.
- Other selling expenses and commissions decreased \$7.5 million, or 17.3%. This decrease is due largely to a decrease in incentive payments made to Horizon. Incentive payments to Horizon are eliminated in consolidation at the Air Group level.

[Table of Contents](#)

- Landing fees and other rentals increased \$4.0 million, or 11.9%. The higher rates primarily reflect higher joint-use rental fees at Seattle, Portland and Los Angeles, combined with modest volume growth. We expect landing fees and other rentals to continue to increase as a result of airport facility expansions and increased costs for security due to unfunded government mandates.

Horizon Air Revenues

For the quarter, operating revenues increased \$6.6 million, or 5.0% as compared to 2003. This increase is due largely to \$12.4 million in revenue from contract flying for Frontier Airlines, which began January 1, 2004, partially offset by a 4.4% decrease in revenue associated with the Horizon brand ("native network") flying resulting from a decrease in incentive payments made from Alaska to Horizon.

For the three months ending September 30, 2004, capacity increased 18.4% and traffic was up 29.0%, compared to the same period in 2003. Contract flying with Frontier represented approximately 23.1% of capacity and 9.2% of passenger revenues during the third quarter of 2004. Passenger load factor increased 5.9 percentage points to 72.4%. Passenger yield decreased 18.0% to 22.38 cents, reflecting the inclusion of the Frontier contract flying, the yield for which is significantly lower than native network flying, and a slight decrease in yield from native network flying. Contract revenue and increases in traffic, combined with lower native network yields and a decrease in incentive payments from Alaska to Horizon resulted in an increase in passenger revenue of \$7.3 million, or 5.7%.

Horizon Air Expenses

Operating expenses increased \$9.6 million, or 8.5%, as compared to the same period in 2003. Total operating expenses per ASM decreased 8.4% as compared to 2003. Operating expenses per ASM excluding fuel decreased 11.4% as compared to the same period in 2003. Explanations of other significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits increased \$0.5 million, or 1.3%, due primarily to a 2.1% increase in the average number of employees partially offset by a \$2.0 million accrual reduction for estimated medical costs.
- Aircraft fuel increased \$4.7 million, or 34.8%, due to a 50.4% increase in the GAAP fuel cost per gallon, partially offset by a 10.3% decrease in gallons consumed, reflecting the addition of four aircraft as compared to the same period in 2003, offset by a reduction in fuel consumption for the capacity flown in the Frontier JetExpress operation. Horizon's fuel hedge contracts are consistent with those at Alaska.

[Table of Contents](#)

The following table summarizes fuel cost per gallon realized by Horizon (the economic cost per gallon), on a GAAP basis (including hedging gains recorded in aircraft fuel and non-operating income (expense)) and fuel cost per gallon excluding all hedging activities:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Fuel expense before hedge activities ("raw fuel") | \$ 14.3 | \$ 18.7 | \$ 40.8 | \$ 49.9 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| Raw fuel cost per gallon | 98.6¢ | 143.8¢ | 100.2¢ | 134.1¢ |
| Fuel expense before hedge activities ("raw fuel") | \$ 14.3 | \$ 18.7 | \$ 40.8 | \$ 49.9 |
| Less: gains on settled hedges included in fuel expense | (0.8) | (0.5) | (2.5) | (1.5) |
| GAAP fuel expense | \$ 13.5 | \$ 18.2 | \$ 38.3 | \$ 48.4 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| GAAP fuel cost per gallon | 93.1¢ | 140.0¢ | 94.1¢ | 130.1¢ |
| GAAP fuel expense | \$ 13.5 | \$ 18.2 | \$ 38.3 | \$ 48.4 |
| Less: gains on settled hedges included in nonoperating income (expense) | (0.3) | (1.2) | (0.8) | (1.6) |
| Adjusted fuel | \$ 13.2 | \$ 17.0 | \$ 37.5 | \$ 46.8 |
| Fuel gallons (000,000) | 14.5 | 13.0 | 40.7 | 37.2 |
| Economic fuel cost per gallon | 90.3¢ | 131.2¢ | 91.9¢ | 125.8¢ |
| Mark-to-market gains included in nonoperating income related to hedges that settle in future periods (in millions) | — | \$ 6.9 | — | \$ 9.6 |

- Aircraft maintenance expense increased \$2.7 million, or 37.5%, primarily due to an increase in block hours, fewer aircraft covered by warranty and higher routine maintenance costs for the Q400 fleet.
- Landing fees and other rentals increased \$0.7 million, or 6.8%. Higher landing fees are a result of higher rates and increased costs for capital improvement, debt service and security. We expect landing fees and other rentals to continue to increase as a result of airport facility expansions and increased costs for security.

Consolidated Nonoperating Income (Expense)

Net nonoperating income was \$62.4 million in 2004 compared to net nonoperating expense of \$8.5 million in 2003.

Other-net includes \$2.0 million and \$9.7 million in gains resulting from settled fuel hedge contracts in 2003 and 2004, respectively. In addition, other-net includes mark-to-market hedging gains of \$57.2 million in 2004 as previously discussed.

Comparison of Nine Months Ended September 30, 2004 to Nine Months Ended September 30, 2003

During the nine months ended September 30, 2004, we recorded net income of \$34.8 million, or \$1.29 per diluted share, compared to net income of \$29.6 million, or \$1.11 per diluted share, during the same period of 2003. Our 2003 consolidated net income includes \$71.4 million (\$52.8 million for Alaska and \$18.6 million for Horizon) received in connection with government assistance received under the Emergency Wartime Supplemental Appropriations Act. The 2004 results include four unusual items. First, we recorded a restructuring charge of \$27.5 million (\$15.8 million net of tax, or \$0.59 per share) related to the restructuring initiatives announced in late August and early September. Second, like last quarter, this quarter's results include mark-to-market fuel hedging gains, which reflect the increase in the fair value of our hedge portfolio during the quarter, of \$80.0 million (\$45.9 million net of tax, or \$1.71 per share). These amounts exclude gains realized on contracts which settled during the quarter. Third, 2004 results also include impairment charges of \$39.6 million (\$26.3 million net of tax, or \$0.98 per share), substantially all of which was associated with a decision to accelerate the retirement of the Company's Boeing 737-200C fleet. Finally, this quarter's results include the recovery of certain disputed Mexico navigation fees which were originally paid in 2002 and 2003, that amounted to \$11.0 million (\$6.3 million net of tax, or \$0.23 per share). Without these items in 2004 and excluding the government compensation received in 2003, net income would have been \$24.7 million, or \$0.92 per share during 2004, compared to a net loss of \$14.7 million, or \$0.55 per share, in 2003. Financial and statistical data comparisons for Alaska and Horizon are shown on pages 20 and 21, respectively. A discussion of the nine-month data follows. On pages 22 through 24, we have included a reconciliation of reported non-GAAP financial measures to the most directly comparable GAAP financial measures.

Alaska Airlines Revenues

Operating revenues increased \$187.2 million, or 12.3%, during 2004 as compared to 2003. For the first nine months of 2004, ASM's increased 7.8% and RPM's increased 12.0%.

Yield per passenger mile remained flat at 12.61 cents and passenger load factor increased 2.7 points during the first nine months of 2004 as compared to the same period in 2003. Increases in traffic and yield resulted in a 12.0% increase in passenger revenues in 2004.

Freight and mail revenues increased \$5.5 million, or 9.2%, compared to the same period in 2003 because of a new mail contract we have in the State of Alaska.

Other-net revenues increased \$16.0 million, or 19.3%, due largely to revenues received from an agreement with PenAir to provide flight services to Dutch Harbor that began in January of 2004 and higher Mileage Plan revenues.

Alaska Airlines Expenses

For the nine months ended September 30, 2004, total operating expenses increased \$208.7 million, or 13.7%, as compared to the same period in 2003. Operating expenses per ASM increased 5.4% in 2004 as compared to 2003. These increases are due largely to the 7.8% increase in capacity combined with a significant increase in fuel costs, higher wages and benefits, landing fees and other rental costs, restructuring charges and an impairment charge related to our Boeing 737-200 fleet. Operating expense per ASM excluding fuel, navigation fee recovery, restructuring and impairment charges decreased 3.9% as compared to the same period in 2003. Explanations of significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits increased \$33.1 million, or 5.7%, during the first nine months of 2004. Approximately \$12.5 million of this increase reflects higher benefit costs, resulting from increases in pension, medical and health insurance costs. The remaining \$20.6 million increase primarily reflects scale and step increases.

In May of 2004, under terms of our union contract, our pilots received a 4% wage rate increase, which represented approximately 51.0% of the total increase in wages.

- Contracted services increased \$9.4 million, or 15.4%, due largely to expenses associated with an agreement with PenAir to provide flight services to Dutch Harbor that began in January of 2004, costs associated with a temporary charter contract we have for our new mail contract in Alaska and higher security costs, partially offset by the recovery in 2004 of disputed Mexico navigation fees paid in 2002 and 2003.
- Aircraft fuel increased \$104.2 million, or 44.9%, due to a 37.4% increase in the GAAP fuel cost per gallon and a 5.4% increase in fuel gallons consumed. Air Group's fuel hedging program resulted in Alaska recognizing a \$11.0 million reduction in aircraft fuel expense for hedging gains realized on hedge positions settled during the first half of 2004.
- Aircraft maintenance decreased \$6.4 million, or 5.4%, due largely to fewer engine overhauls during the first nine months and a change in the mix of heavy maintenance versus routine maintenance.
- Aircraft rent decreased \$7.3 million, or 7.9%, due to lower rates on extended leases and MD-80 returns, offset by one new 737-700 aircraft and one new 737-900 aircraft since the end of the third quarter of 2003.
- Depreciation and amortization increased \$7.4 million, or 8.4%, reflecting accelerated depreciation on the planned retirement of three Boeing 737-200C's and an increase in depreciation resulting from two aircraft purchased in the last twelve months.
- Landing fees and other rentals increased \$12.6 million, or 13.5%. The higher rates primarily reflect higher joint-use rental fees at Seattle, Portland, Los Angeles and Oakland, combined with modest volume growth. We expect landing fees and other rentals to continue to increase as a result of airport facility expansions and increased costs for security due to unfunded government mandates.

[Table of Contents](#)

- Other expense increased \$8.1 million, or 7.9%, primarily reflecting a \$6.4 million increase in professional services and a \$1.1 million increase in property taxes.

Horizon Air Revenues

For the first nine months of 2004, operating revenues increased \$32.0 million, or 9.3% as compared to 2003. This increase is due largely to a 0.1% increase in revenue associated with the native network flying combined with \$31.8 million in revenue from contract flying for Frontier Airlines, which began January 1, 2004.

For the nine months ended September 30, 2004, capacity increased 18.7% and traffic was up 29.6%, compared to the same period in 2003. Contract flying with Frontier represented approximately 8.8% of passenger revenues and 20.8% of capacity, during the first nine months of 2004. Passenger load factor increased 5.7 percentage points to 68.5%. Passenger yield decreased 14.9% to 22.73 cents, reflecting the inclusion of the Frontier contract flying, the yield for which is significantly lower than native network flying. Contract revenue and higher yields in Horizon's native network combined with the increases in traffic, resulted in an increase in passenger revenue of \$33.6 million, or 10.3%.

Horizon Air Expenses

Operating expenses increased \$23.8 million, or 7.0%, as compared to the same period in 2003. Operating expenses per ASM including fuel and the impairment charge decreased 10.0% as compared to 2003. Operating expenses per ASM excluding fuel and the impairment charge decreased 12.7% as compared to the same period in 2003. Operating expenses include \$2.8 million related to an impairment charge on our held-for-sale F-28 aircraft and spare engines to lower the carrying value of these assets to their estimated fair value. Explanations of other significant period-over-period changes in the components of operating expenses are as follows:

- Wages and benefits increased \$3.3 million, or 2.8%, reflecting an increase in the average number of employees and in average wages and payroll taxes, partially offset by an accrual reduction for medical costs resulting from a downward trend in claims activity.
- Aircraft fuel increased \$10.1 million, or 26.4%, due to a 38.3% increase in the GAAP fuel cost per gallon, partially offset by an 8.6% decrease in gallons consumed, reflecting the addition of four aircraft as compared to the same period in 2003, offset by the reduction in fuel consumption for the capacity flown in the Frontier JetExpress operation. Air Group's fuel hedging program resulted in Horizon recognizing a \$1.5 million reduction in aircraft fuel expense for hedging gains realized on hedge positions settled during the first nine months of 2004.
- Aircraft maintenance expense increased \$4.1 million, or 18.2%, primarily due to an increase in block hours, a higher number of routine maintenance activities and engine overhauls for the Q200 fleet and less aircraft covered by warranty.
- Aircraft rent increased \$2.7 million, or 5.1%, reflecting the addition of one CRJ and the addition of spare engines in 2004 as compared to the same period in 2003.

[Table of Contents](#)

- Landing fees and other rentals increased \$3.0 million, or 10.6%. Higher landing fees are a result of higher rates associated with modest volume growth, an increase in airport fees and increased costs for security. We expect landing fees and other rentals to continue to increase as a result of airport facility expansions and increased costs for security.

Consolidated Nonoperating Income (Expense)

Net nonoperating income was \$74.6 million in 2004 compared to \$54.4 million in 2003. Interest income increased \$7.1 million due to a larger marketable securities portfolio in 2004 combined with a negative adjustment of premium and discount amortization on our marketable securities portfolio in 2003. Interest expense (net of capitalized interest) increased \$1.1 million due to increases in debt balances as compared to 2003.

The 2003 results include \$71.4 million (\$52.8 million for Alaska and \$18.6 million for Horizon) received in connection with the government reimbursement of security fees remitted and carrier fees paid under the Emergency Wartime Supplemental Appropriations Act.

Other-net includes \$5.4 million and \$13.3 million in gains from settled fuel hedging contracts in 2003 and 2004, respectively. In addition, other-net includes mark-to-market gains on unsettled hedge contracts of \$80.0 million in 2004.

Consolidated Income Tax Benefit

Accounting standards require us to provide for income taxes each quarter based on either our estimate of the effective tax rate for the full year or the actual year-to-date effective tax rate if it is our best estimate of our annual expectation. The volatility of airfares and fuel prices and the seasonality of our business make it difficult to accurately forecast full-year pretax results. In addition, a relatively small change in pretax results can cause a significant change in the effective tax rate due to the magnitude of nondeductible expenses, such as employee per diem costs, relative to pretax profit or loss. We used our actual 2004 year-to-date effective rate of 42.7%. In arriving at this rate, we considered a variety of factors, including year-to-date pretax results, the U.S. federal rate of 35%, estimated year-to-date nondeductible expenses and estimate state income taxes. We evaluate this rate each quarter and make adjustments when necessary.

Critical Accounting Policies

For information on our critical accounting policies, see Item 7 of our Annual Report on Form 10-K/A for the year ended December 31, 2003.

Liquidity and Capital Resources

The table below presents the major indicators of financial condition and liquidity.

| | December 31, 2003 | September 30, 2004 | Change |
|---|---|--------------------|---------|
| | (In millions, except per share and debt-to-capital amounts) | | |
| Cash and marketable securities | \$ 812.3 | \$ 878.5 | \$ 66.2 |
| Working capital | 130.9 | 336.2 | 205.3 |
| Long-term debt and capital lease obligations | 906.9 | 1,007.6 | 100.7 |
| Shareholders' equity | 674.2 | 713.6 | 39.4 |
| Book value per common share | \$ 25.19 | \$ 26.54 | \$ 1.35 |
| Long-term debt-to-capital | 57%:43% | 59%:41% | NA |
| Long-term debt-to-capital assuming aircraft operating leases are capitalized at seven times annualized rent | 77%:23% | 77%:23% | NA |

During the nine months ended September 30, 2004, our cash and marketable securities increased \$66.2 million to \$878.5 million at September 30, 2004. This increase reflects cash provided by operating activities of \$283.5 million, partially offset by cash used in financing activities of \$96.3 million and cash used for the purchase of property and equipment of \$113.5 million.

Cash Provided by Operating Activities

During the first nine months of 2004, net cash provided by operating activities was \$283.5 million (including \$42.7 million of cash received from a tax refund during the second quarter of 2004), versus \$272.5 million during the first nine months of 2003.

Cash Used in Investing Activities

Cash used in investing activities was \$157.2 million during the first nine months of 2004, compared to \$508.6 million in 2003. We had net purchases of \$39.2 million of marketable securities and \$113.5 million for property and equipment. During the first nine months of 2004, our aircraft related capital expenditures decreased \$197.8 million as compared to 2003, primarily reflecting a reduction in spending for new aircraft and capitalized overhauls.

Cash Provided by (Used in) Financing Activities

Net cash used in financing activities was \$96.3 million during the first nine months of 2004 compared to net cash provided by financing activities of \$188.8 million during the same period in 2003. Debt issuances during the first nine months of 2004 of \$94.6 million were secured by flight equipment. These debt issuances have interest rates that vary with the London Interbank Offered Rate (LIBOR) and payment terms ranging from 12 to 16 years. Debt issuances during the period were offset by normal long-term debt payments of \$43.2 million and full repayment of our credit facility of \$150 million.

We plan to meet our capital and operating commitments through internally generated funds from operations and cash and marketable securities on hand at September 30, 2004 totaling \$878.5 million. We also have restricted cash of \$14.2 million, which is intended to collateralize interest payments due in the next two years on our \$150 million floating rate senior convertible notes due 2023 issued in 2003.

[Table of Contents](#)

In 2003, we completed the private placement of \$150.0 million of floating rate senior convertible notes due in 2023 pursuant to Rule 144A of the Securities Act of 1933, as amended. Net proceeds from the offering were \$144.9 million, of which \$22.3 million was used to acquire U.S. government securities to fund the first three years of interest payments. In 2003, we made a capital contribution to Alaska Airlines of the remaining net proceeds from the sale of the notes. Alaska Airlines has used the remaining proceeds from the notes for working capital requirements and expects in the future to continue to use these remaining proceeds for working capital requirements as well as other general corporate purposes. Although we have not yet determined how each payment of principal or interest due will be funded in the future, we anticipate that these payments will be funded either by dividends, distributions, loans, advances or other payments from our subsidiaries or through new borrowings or financings by Alaska Air Group. Any such payments by our subsidiaries to us could be subject to statutory or contractual restrictions. Currently, the only contractual restrictions are contained in Alaska Airlines' \$150 million credit facility, which expires in December 2004 and requires maintenance of specific levels of net worth, maintenance of certain debt and leases to net worth, leverage and fixed charge coverage ratios, and limits on investments, lease obligations, sales of assets, and additional indebtedness. Such provisions limit the amount of funds Alaska Airlines can distribute via dividend to Alaska Air Group. As of September 30, 2004, \$195.3 million was available to distribute to Alaska Air Group via dividend without violating the covenants in Alaska Airlines' credit facility. The notes do not restrict the ability of our subsidiaries to enter into additional agreements limiting or prohibiting the distribution of earnings, loans or other payments to Alaska Air Group. We are considering various alternatives including renewing or replacing the credit facility, although there can be no assurance that this can be accomplished on acceptable terms to us.

The holders of the \$150.0 million of floating rate senior convertible notes due in 2023 may elect to have the Company redeem all or a portion of the notes on the 5th, 10th and 15th anniversaries of the date of issuance. On September 30, 2004, we entered into the First Supplemental Indenture with respect to the Notes to rescind the Company's right to pay for such a repurchase of the Notes at the option of the holders, in whole or in part, in shares of our common stock. Pursuant to the terms of the notes, as amended, any such repurchases shall be paid for in cash.

Supplemental Disclosure of Noncash Investing and Financing Activities

During the first nine months of 2004, Horizon financed three Bombardier Q400s under long-term debt arrangements totaling \$44.7 million. These debt arrangements have a 15-year term and interest rates that vary with LIBOR. Two of the aircraft were originally leased in January 2004 and were treated as capital leases at that time. The resulting re-financing transactions did not result in any gain or loss in the consolidated statements of operations.

Contractual Obligations, Commitments and Off-Balance Sheet Arrangements

At September 30, 2004, we had firm orders for 12 aircraft requiring aggregate payments of approximately \$284.4 million, as set forth below. In addition, Alaska has options to acquire 26 additional B737's, and Horizon has options to acquire 15 Q400's and 25 CRJ 700's. Alaska and Horizon expect to finance the firm orders and to the extent exercised, the option aircraft with leases, long-term debt or internally generated cash. During the first quarter of 2004, Alaska converted two 737-900 aircraft it had on firm order with Boeing for two 737-800s. The planes are due for delivery in February and July of 2005.

[Table of Contents](#)

The following table summarizes aircraft commitments and payments by year:

| Aircraft | Delivery Period - Firm Orders | | | | | | Total |
|---------------------|--------------------------------|--------|--------|--------|--------|----------------|---------|
| | October 1-December 31, 2004 | 2005 | 2006 | 2007 | 2008 | Beyond 2008 | |
| Boeing 737-800 | — | 3 | — | — | — | — | 3 |
| Bombardier CRJ700 | — | 1 | 2 | 2 | 2 | 2 | 9 |
| Total | — | 4 | 2 | 2 | 2 | 2 | 12 |
| Payments (Millions) | \$12.9 | \$82.4 | \$52.5 | \$49.5 | \$49.6 | \$37.5 | \$284.4 |

The table above does not include our planned acquisition of three Boeing 737-800's in 2006 to replace the Boeing 737-400's being converted since we do not have firm commitments at this time.

The following table provides a summary of our principal payments under current and long-term debt obligations, capital lease obligations, operating lease commitments and aircraft purchase commitments as of September 30, 2004. This table excludes other obligations that we may have, such as pension obligations and routine purchase obligations entered into in the normal course of business.

| (in millions) | October 1-December 31, | | | | | | |
|--|------------------------|---------|---------|---------|---------|-----------------|-----------|
| | 2004 | 2005 | 2006 | 2007 | 2008 | Beyond 2008* | Total |
| Current and long-term debt and capital lease obligations | \$ 16.7 | \$ 53.5 | \$ 57.1 | \$ 60.2 | \$ 63.3 | \$ 808.9 | \$1,059.7 |
| Operating lease commitments | 82.2 | 278.0 | 223.3 | 195.9 | 189.5 | 1,136.1 | 2,105.0 |
| Aircraft purchase commitments | 12.9 | 82.4 | 52.5 | 49.5 | 49.6 | 37.5 | 284.4 |
| Total | \$111.8 | \$413.9 | \$332.9 | \$305.6 | \$302.4 | \$1,982.5 | \$3,449.1 |

* Includes \$150 million related to the Company's senior convertible notes due in 2023. Holders of these Notes may require the Company to purchase all or a portion of their Notes, for a purchase price equal to principal plus accrued interest, on the 5th, 10th, and 15th anniversaries of the issuance of the Notes, or upon the occurrence of a change in control or tax event. See Note 8 in the condensed consolidated financial statements.

New Accounting Standards

During the third quarter of 2004, the Emerging Issues Task Force (EITF) affirmed its tentative conclusion reached in July of 2004 on EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted EPS" (EITF 04-08). EITF 04-08 requires companies to include certain contingently convertible securities in the calculation of diluted EPS to the extent the inclusion of the shares would be dilutive. Adoption of EITF 04-08 is expected to be required during the fourth quarter of 2004 and will impact periods and comparative periods on a go forward basis. Because the Company's convertible notes fall under the scope of EITF 04-08, beginning in the fourth quarter of 2004 and for all comparative periods presented, the Company expects to report a lower diluted EPS to the extent the convertible notes are not anti-dilutive. Had EITF 04-08 been required during the third quarter of 2003 and 2004, diluted EPS would include an additional 5.7 million shares and would have resulted in diluted EPS of \$1.29 and \$2.47 for the three months ended September 30, 2003 and 2004,

respectively, and \$1.00 and \$1.20 per share for the nine months ended September 30, 2003 and 2004, respectively.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in market risk from the information provided in Item 7A “Quantitative and Qualitative Disclosure About Market Risk” in our 2003 10-K/A except as follows:

Fuel Hedging

We purchase jet fuel at prevailing market prices, and seek to manage the risk of price fluctuations through execution of a documented hedging strategy. We utilize derivative financial instruments as hedges to decrease our exposure to the volatility of jet fuel prices. We believe there is risk in not hedging against the possibility of fuel price increases. At September 30, 2004, we had fuel hedge contracts in place to hedge 49.0 million gallons of our expected jet fuel usage during the remainder of 2004, 207.3 million gallons in 2005, 106.1 million gallons in 2006 and 16.6 million gallons in 2007. This represents 50% of our anticipated fuel consumption in 2004 and 2005 and 25% and 4% of our anticipated fuel consumption in 2006 and 2007, respectively. Prices of these agreements range from \$28.81 to \$37.28 per crude oil barrel. We estimate that a 10% increase or decrease in crude oil prices as of September 30, 2004 would impact hedging positions by approximately \$6.0 million.

As of December 31, 2003 and September 30, 2004, the fair values of our fuel hedge positions were \$18.4 million and \$117.0 million, respectively. Of these amounts, \$12.0 million of the 2003 fair value amounts and \$81.6 million of the 2004 fair value amounts were included in prepaid and other current assets in the consolidated balance sheets. The remaining \$6.4 million 2003 fair value and \$35.4 million 2004 fair value is reflected in other assets in the consolidated balance sheets.

The following table summarizes Air Group’s realized fuel hedging gains and changes in fair value of hedging contracts outstanding as of September 30, 2004 and 2003 (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|---------|
| | 2003 | 2004 | 2003 | 2004 |
| Settled hedging gains included in aircraft fuel | \$ 5.1 | \$ 4.0 | \$ 16.5 | \$ 12.5 |
| Settled hedging gains (losses) included In non-operating income (expense)*** | \$ (0.8) | \$ 9.7 | \$ 4.3 | \$ 13.3 |
| Mark-to-market hedging gains included in non-operating income (expense)** | \$ — | \$ 57.2 | \$ — | \$ 80.0 |
| Hedging gains included in non-operating income (expense)* | \$ (0.8) | \$ 66.9 | \$ 4.3 | \$ 93.3 |

* Includes the ineffective portion recorded currently in earnings using “hedge accounting” through the first three months of 2004.

** Includes changes in fair value since March 31, 2004 resulting from the loss of “hedge accounting”.

*** 2003 includes the ineffective portion of fair market value changes under “hedge accounting”.

[Table of Contents](#)

Financial Market Risk

During the first nine months of 2004, we issued \$94.6 million of debt secured by flight equipment, having interest rates that vary with LIBOR and payment terms ranging from 12 to 16 years.

ITEM 4. Controls and Procedures

As of September 30, 2004, an evaluation was performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer (collectively, our “certifying officers”), of the effectiveness of the design and operation of our disclosure controls and procedures. These disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in our periodic reports filed with the Securities and Exchange Commission (the SEC) is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms, and that the information is communicated to our certifying officers on a timely basis.

Our certifying officers concluded, based on their evaluation, that disclosure controls and procedures were effective.

We made no changes in our internal controls over financial reporting during the fiscal quarter ended September 30, 2004, that our certifying officers concluded materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We intend to regularly review and evaluate the design and effectiveness of our disclosure controls and procedures and internal controls over financial reporting on an ongoing basis and to improve these controls and procedures over time and to correct any deficiencies that we may discover in the future. While we believe the present design of our disclosure controls and procedures and internal controls over financial reporting are effective, future events affecting our business may cause us to modify our these controls and procedures in the future.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We are a party to ordinary routine litigation incidental to our business and with respect to which no material liability is expected. Management believes the ultimate disposition of these matters is not likely to materially affect our financial position or results of operations. This forward-looking statement is based on management’s current understanding of the relevant law and facts; it is subject to various contingencies, including the potential costs and risks associated with litigation and the actions of judges and juries.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

ITEM 3. Default on Senior Securities

None

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 5. Other Information

No changes have been made to the procedures by which security holders may recommend nominees to our Board of Directors since the filing of our definitive proxy statement for our 2004 annual meeting of shareholders.

[Table of Contents](#)

Signatures

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

ALASKA AIR GROUP, INC.

Registrant

Date: November 9, 2004

By: /s/ Brandon S. Pedersen

Brandon S. Pedersen
Staff Vice President/Finance and Controller

By: /s/ Bradley D. Tilden

Bradley D. Tilden
Executive Vice President/Finance and Chief Financial Officer

EXHIBIT INDEX

Pursuant to Item 601(a)(2) of Regulation S-K, this Exhibit Index immediately precedes the exhibits.

The following exhibits are numbered in accordance with Item 601 of Regulation S-K.

| Exhibit No. | Description |
|-------------|--|
| 4.1* | Indenture dated as of March 31, 2003 between Alaska Air Group, Inc. and U.S. Bank National Association, as Trustee, and First Supplemental Indenture dated September 30, 2004 between Alaska Air Group, Inc. and U.S. Bank National Association as Trustee, relating to senior convertible notes due 2023. |
| 10.19* | 2004 Alaska Air Group performance based pay plan*** |
| 31.1* | Section 302 Certification of Chief Executive Officer Pursuant to 15 U.S.C. Section 7241 |
| 31.2* | Section 302 Certification of Chief Financial Officer Pursuant to 15 U.S.C. Section 7241 |
| 32.1* | Section 906 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 |
| 32.2* | Section 906 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 |

* Filed herewith.

*** Indicates management contract or compensatory plan or arrangement.

FIRST SUPPLEMENTAL INDENTURE

Dated as of September 30, 2004

Supplement to Indenture dated as of March 21, 2003

between

ALASKA AIR GROUP, INC.

and

U.S. BANK NATIONAL ASSOCIATION

AS TRUSTEE
-----Senior Convertible Notes
due 2023

TABLE OF CONTENTS

| | PAGE |
|--|------|
| | ---- |
| RECITALS..... | 1 |
| ARTICLE 1 | |
| RATIFICATION; DEFINITIONS | |
| SECTION 1.01. First Supplemental Indenture..... | 2 |
| SECTION 1.02. Definitions..... | 2 |
| ARTICLE 2 | |
| AMENDMENTS TO CERTAIN PROVISIONS OF THE ORIGINAL INDENTURE | |
| SECTION 2.01. Amendments to Section 3.08 of the Original Indenture..... | 2 |
| ARTICLE 3 | |
| AMENDMENTS TO CERTAIN PROVISIONS OF THE SECURITIES; NOTATION ON THE SECURITIES | |
| SECTION 3.01. Amendments to Section 4 of the Securities..... | 6 |
| SECTION 3.02. Amendments to Section 7 of the Securities..... | 5 |
| SECTION 3.03. Notation on Securities..... | 7 |
| ARTICLE 4 | |
| MISCELLANEOUS | |
| SECTION 4.01. Trust Indenture Act Controls..... | 8 |
| SECTION 4.02. Incorporation into Indenture..... | 8 |
| SECTION 4.03. Successors and Assigns..... | 8 |
| SECTION 4.04. Governing Law..... | 8 |
| SECTION 4.05. Multiple Originals..... | 8 |
| SECTION 4.06. Separability Clause..... | 8 |
| SECTION 4.07. The Trustee..... | 8 |

RECITALS

WHEREAS, the Company and the Trustee executed and delivered an Indenture, dated as of March 21, 2003 (the "Original Indenture"; and, as amended by this First Supplemental Indenture, the "Indenture"), to provide for the issuance by the Company of its Senior Convertible Notes due 2023 (the "Securities");

WHEREAS, the Company desires to amend the Original Indenture and the Securities to rescind the Company's right pursuant to Section 3.08 of the Original Indenture and the Securities to pay for the purchase of Securities at the option of the Holder pursuant to such section, in whole or in part, in shares of Common Stock in lieu of cash;

WHEREAS, Section 9.01 of the Original Indenture provides that, without the consent of any Securityholder, the Company and the Trustee may amend the Original Indenture or the Securities to, among other things, make any change that does not adversely affect the rights of any Holders; and

WHEREAS, all things necessary for the execution of this First Supplemental Indenture, and to make this First Supplemental Indenture a valid supplement to the Original Indenture according to its terms and a valid and binding agreement of the Company, have been done.

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants and agreements hereinafter set forth, the parties hereto agree, for the benefit of the other party and for the equal and ratable benefit of the Holders, as follows:

1

ARTICLE 1

RATIFICATION; DEFINITIONS

SECTION 1.01. First Supplemental Indenture. This First Supplemental Indenture is supplemental to, and is entered into in accordance with Section 9.01 of the Original Indenture and, except as modified, amended and supplemented by this First Supplemental Indenture, the provisions of the Original Indenture are ratified and confirmed in all respects and shall remain in full force and effect.

SECTION 1.02. Definitions. Capitalized terms used but not defined herein shall have the meanings assigned to them in the Original Indenture.

ARTICLE 2

AMENDMENTS TO CERTAIN PROVISIONS OF THE ORIGINAL INDENTURE

SECTION 2.01. Amendments to Section 3.08 of the Original Indenture. Section 3.08 of the Original Indenture is hereby amended and restated to read in its entirety as follows:

"SECTION 3.08 Purchase of Securities at Option of the Holder

(a) General. Securities shall be purchased by the Company pursuant to paragraph 7 of the Securities as of March 21, 2008, 2013 and 2018 (each, a "Purchase Date"), at a purchase price equal to the Variable Principal Amount of the Securities on the applicable Purchase Date plus accrued and unpaid cash interest, if any, (the "Purchase Price"), at the option of the Holder thereof, upon:

(1) delivery to the Paying Agent, by the Holder of a written notice of purchase (a "Purchase Notice") at any time from the opening of business on the date that is 20 Business Days prior to a Purchase Date until the close of business on such Purchase Date stating:

(A) the certificate numbers of the Securities which the Holder will deliver to be purchased,

(B) the portion of the Original Principal Amount of the Securities which the Holder will deliver to be purchased, which portion must be an Original Principal Amount of \$1,000 or an integral multiple thereof,

(C) that such Security shall be purchased as of the Purchase Date pursuant to the terms and conditions specified in paragraph 7 of the Securities and in this Indenture; and

(2) delivery of such Security to the Paying Agent prior to, on or after the Purchase Date (together with all necessary endorsements) at the offices

2

of the Paying Agent, such delivery being a condition to receipt by the Holder of the Purchase Price therefor; provided, however, that such Purchase Price shall be so paid pursuant to this Section 3.08 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof in the related Purchase Notice, as determined by the Company.

The Company shall purchase from the Holder thereof, pursuant to this Section 3.08, a portion of a Security if the Original Principal Amount of such portion is \$1,000 or an integral multiple of \$1,000. Provisions of this Indenture that apply to the purchase of all of a Security also apply to the purchase of such portion of such Security.

Any purchase by the Company contemplated pursuant to the provisions of this Section 3.08 shall be consummated by the delivery of the consideration to be received by the Holder (together with accrued and unpaid cash interest, if any) promptly following the later of the Purchase Date and the time of delivery of the Security.

Notwithstanding anything herein to the contrary, any Holder delivering to the Paying Agent the Purchase Notice contemplated by this Section 3.08(a) shall have the right to withdraw such Purchase Notice at any time prior to the close of business on the business day prior to the Purchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 3.10.

The Paying Agent shall promptly notify the Company of the receipt by it of any Purchase Notice or written notice of withdrawal thereof.

(b) Manner of Payment of Purchase Price. The Securities to be purchased pursuant to Section 3.08(a) shall be paid for in U.S. legal tender ("cash"), subject to the conditions set forth in Sections 3.08(c).

At least three Business Days before the Company Notice Date, the Company shall deliver an Officers' Certificate to the Trustee specifying:

(i) the information required by Section 3.08(e), and

(ii) whether the Company desires the Trustee to give the Company Notice required by Section 3.08(e).

(c) Purchase with Cash. On each Purchase Date, the Purchase Price of Securities in respect of which a Purchase Notice pursuant to Section 3.08(a) has been given, shall be paid by the Company with cash equal to the aggregate Purchase Price of such Securities. The Company Notice, as provided in Section 3.08(e), shall be sent to Holders (and to beneficial owners as required by applicable law) not less than 20 Business Days prior to such Purchase Date (the "Company Notice Date").

3

(d) Certain Definitions.

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

The "Market Price" of the Common Stock means the average of the Sale Prices of the Common Stock for the five trading day period ending on the third Business Day (if the third Business Day prior to the applicable Purchase Date is a trading day or, if not, then on the last trading day) prior to the applicable Purchase Date, appropriately adjusted to take into account the occurrence, during the period commencing on the first of such trading days during such five trading day period and ending on such Purchase Date, of any event described in

Section 11.06, 11.07 or 11.08; subject, however, to the conditions set forth in Sections 11.09 and 11.10.

"Securities Act" means the Securities Act of 1933, as amended.

(e) Notice. The Company's notice shall be sent to the Holders (and to beneficial owners as required by applicable law) in the manner provided in Section 14.02 at the time specified in Section 3.08(c) (the "Company Notice"). Each Company Notice shall include a form of Purchase Notice to be completed by a Securityholder and shall state:

(i) the Purchase Price, the Conversion Rate and accrued and unpaid cash interest, if any, that will be accrued and payable with respect to the Securities as of the Purchase Date;

(ii) the name and address of the Paying Agent and the Conversion Agent;

(iii) that Securities as to which a Purchase Notice has been given may be converted pursuant to Article 11 hereof only if the applicable Purchase Notice has been withdrawn in accordance with the terms of this Indenture;

(iv) that Securities must be surrendered to the Paying Agent to collect payment of the Purchase Price and interest, if any;

(v) that the Purchase Price for any Security as to which a Purchase Notice has been given and not withdrawn, together with any cash interest payable with respect thereto, will be paid promptly following the later of the Purchase Date and the time of surrender of such Security as described in (iv);

(vi) the procedures the Holder must follow to exercise rights under Section 3.08 and a brief description of those rights;

(vii) briefly, the conversion rights of the Securities and that Holders who want to convert Securities must satisfy the requirements set forth in paragraph 9 of the Securities;

4

(viii) the procedures for withdrawing a Purchase Notice (including, without limitation, for a conditional withdrawal pursuant to the terms of Section 3.10);

(ix) that, unless the Company defaults in making payment of such Purchase Price and cash interest, if any, the Variable Principal Amount will cease to increase and cash interest, if any, on Securities surrendered for purchase will cease to accrue on and after the Purchase Date; and

(x) the CUSIP number of the Securities.

At the Company's request, the Trustee shall give such Company Notice in the Company's name and at the Company's expense; provided, however, that, in all cases, the text of such Company Notice shall be prepared by the Company.

(f) [Intentionally Deleted]

(g) Procedure upon Purchase. The Company shall deposit cash at the time and in the manner as provided in Section 3.11, sufficient to pay the aggregate Purchase Price of, and any accrued and unpaid interest with respect to all Securities to be purchased pursuant to this Section 3.08.

(h) Taxes. Nothing herein shall preclude any income tax withholding required by law or regulations."

ARTICLE 3

AMENDMENTS TO CERTAIN PROVISIONS OF THE SECURITIES; NOTATION ON THE SECURITIES

SECTION 3.01. Amendments to Section 4 of the Securities. Section 4

of the Securities is hereby amended and restated to read in its entirety as follows:

"4. Indenture and First Supplemental Indenture.

The Company issued the Securities pursuant to an Indenture dated as of March 21, 2003 (the "Original Indenture"), between the Company and the Trustee. Pursuant to Section 9.01 of the Original Indenture, the Company and the Trustee entered into a First Supplemental Indenture, dated as of August 31, 2004 (the "First Supplemental Indenture"), to rescind the Company's right to pay for the purchase of the Securities at the option of the Holder in shares of Common Stock in lieu of cash. The terms of the Securities include those stated in the Original Indenture, as amended by the First Supplemental Indenture (as so amended, the "Indenture"), and those made part of the Indenture by reference to the Trust Indenture Act of 1939, as in effect from time to time (the "TIA"). Capitalized terms used herein and not defined herein have the meanings ascribed thereto in the Indenture. The Securities are subject to all such terms, and

5

Securityholders are referred to the Indenture and the TIA for a statement of those terms.

The Securities are unsecured (subject to Article XIII of the Indenture) and unsubordinated obligations of the Company limited to \$150,000,000 aggregate Original Principal Amount (subject to Section 2.07 of the Indenture). The Indenture does not limit other indebtedness of the Company, secured or unsecured."

SECTION 3.02. Amendments to Section 7 of the Securities. Section 7 of the Securities is hereby amended and restated to read in its entirety as follows:

"7. Purchase by the Company at the Option of the Holder.

Subject to the terms and conditions of the Indenture, the Company shall become obligated to purchase, at the option of the Holder, the Securities held by such Holder on March 21, 2008, March 21, 2013 and March 21, 2018 at a purchase price equal to the Variable Principal Amount of such Securities on the applicable Purchase Date plus accrued and unpaid cash interest, if any, upon delivery of a Purchase Notice containing the information set forth in the Indenture, at any time from the opening of business on the date that is 20 Business Days prior to such Purchase Date until the close of business on the day immediately preceding such Purchase Date and upon delivery of the Securities to the Paying Agent by the Holder as set forth in the Indenture. The Purchase Price shall be paid in cash in accordance with the Indenture.

If prior to a Purchase Date this Security has been converted to a quarterly coupon note following the occurrence of a Tax Event, the Purchase Price will be equal to the Restated Principal Amount plus accrued and unpaid cash interest from the date of conversion to the Purchase Date as provided in the Indenture.

At the option of the Holder and subject to the terms and conditions of the Indenture, the Company shall become obligated to purchase all or a portion of the Securities in integral multiples of \$1,000 Original Principal Amount held by such Holder no later than 30 Business Days after the occurrence of a Change in Control of the Company for a Change in Control Purchase Price equal to the Variable Principal Amount of such Securities plus accrued and unpaid cash interest, if any, to but not including the Change in Control Purchase Date, which Change in Control Purchase Price shall be paid in cash. If prior to a Change in Control Purchase Date this Security has been converted to a quarterly coupon note following the occurrence of a Tax Event, the Change in Control Purchase Price shall be equal to the Restated Principal Amount plus accrued cash interest from the date of conversion to the Change in Control Purchase Date.

A third party may make the offer and purchase of the Securities in lieu of the Company in accordance with the Indenture.

6

Holders have the right to withdraw any Purchase Notice or Change in Control Purchase Notice, as the case may be, by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture.

If cash sufficient to pay the Purchase Price or Change in Control Purchase Price, as the case may be, of all Securities or portions thereof to be purchased as of the Purchase Date or the Change in Control Purchase Date, as the case may be, is deposited with the Paying Agent on the Business Day following the Purchase Date or the Change in Control Purchase Date, as the case may be, the Variable Principal Amount shall cease to increase, and cash interest, if any, shall cease to accrue on such Securities (or portions thereof) on such Purchase Date or Change in Control Purchase Date, as the case may be, and the Holder thereof shall have no other rights as such (other than the right to receive the Purchase Price or Change in Control Purchase Price, as the case may be, if any, upon surrender of such Security)."

SECTION 3.03. Notation on Securities. (a) The Securities, as amended by the provisions of this First Supplemental Indenture, shall bear a notation substantially to the following effect:

"THE TERMS OF THIS SECURITY HAVE BEEN AMENDED TO THE EXTENT PROVIDED IN THE FIRST SUPPLEMENTAL INDENTURE, DATED AS OF AUGUST 31, 2004, BETWEEN THE COMPANY AND THE TRUSTEE. THE FIRST SUPPLEMENTAL INDENTURE WAS ENTERED INTO BETWEEN THE COMPANY AND THE TRUSTEE PURSUANT TO SECTION 9.01 OF THE INDENTURE TO RESCIND THE COMPANY'S RIGHT TO PAY FOR THE PURCHASE OF THE SECURITIES AT THE OPTION OF THE HOLDER IN SHARES OF COMMON STOCK IN LIEU OF CASH. THE TERMS OF THIS SECURITY INCLUDE THOSE STATED IN THE INDENTURE, AS SUPPLEMENTED BY THE FIRST SUPPLEMENTAL INDENTURE, AND HOLDERS ARE REFERRED TO THE INDENTURE AND THE FIRST SUPPLEMENTAL INDENTURE FOR A STATEMENT OF THOSE TERMS."

(b) The Trustee hereby agrees to cause the Securities to bear the above notation pursuant to, and upon satisfaction of, the conditions set forth in Sections 9.05, 9.06, 14.04 and 14.05 of the Indenture.

7

ARTICLE 4

MISCELLANEOUS

SECTION 4.01. Trust Indenture Act Controls. If any provision of this First Supplemental Indenture limits, qualifies, or conflicts with another provision which is required to be included in this Indenture by the TIA, the required provision shall control.

SECTION 4.02. Incorporation into Indenture. This First Supplemental Indenture and all its provisions shall be deemed a part of the Original Indenture in the manner and to the extent herein and therein provided.

SECTION 4.03. Successors. All covenants and agreements of the Company and the Trustee in this First Supplemental Indenture shall bind their respective successors.

SECTION 4.04. Governing Law. THE LAWS OF THE STATE OF NEW YORK SHALL GOVERN THIS FIRST SUPPLEMENTAL INDENTURE.

SECTION 4.05. Multiple Originals. The parties may sign any number of copies of this First Supplemental Indenture. Each signed copy shall be an original, but all of them together represent the same agreement. One originally signed copy is enough to prove this First Supplemental Indenture.

SECTION 4.06. Separability Clause. In case any provision in this First Supplemental Indenture or in the Securities shall be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

SECTION 4.07 The Trustee. The Trustee shall not be responsible in any manner whatsoever for or in respect of the validity or sufficiency of this First Supplemental Indenture. The recitals herein contained are made by the Company and not by the Trustee, and the Trustee assumes no responsibility for

the correctness thereof.

* * * * *

8

IN WITNESS WHEREOF, the undersigned, being duly authorized, have executed this First Supplemental Indenture on behalf of the respective parties hereto as of the date first above written.

ALASKA AIR GROUP, INC.

By: /s/ Bradley Tilden

Name: Bradley Tilden
Title: Executive Vice President/Finance &
Chief Financial Officer

U.S. BANK NATIONAL ASSOCIATION,
as Trustee

By: /s/ Alison D.B. Nadeau

Name: Alison D.B. Nadeau
Title: Vice President

EXECUTION COPY

ALASKA AIR GROUP, INC.

AND

U.S. BANK NATIONAL ASSOCIATION

as TRUSTEE

Senior Convertible Notes
due 2023

INDENTURE

Dated as of March 21, 2003

CROSS REFERENCE TABLE*

| IA Section..... | Indenture Section |
|-------------------|-------------------|
| 310 (a) (1) | 7.10 |
| (a) (2) | 7.10 |
| (a) (3) | N.A. |
| (a) (4) | N.A. |
| (b) | 7.08; 7.10 |
| (c) | N.A. |
| 311 (a) | 7.11 |
| (b) | 7.11 |
| (c) | N.A. |
| 312 (a) | 2.05 |
| (b) | 14.03 |
| (c) | 14.03 |
| 313 (a) | 7.06 |
| (b) (1) | N.A. |
| (b) (2) | 7.06 |
| (c) | 14.02 |

| | |
|-------------------------------|-------------------|
| (d) | 7.06 |
| 314 (a) | 4.02; 4.03; 14.02 |
| (b) | N.A. |
| (c) (1) | 14.04 |
| (c) (2) | 14.04 |
| (c) (3) | N.A. |
| (d) | N.A. |
| (e) | 14.05 |
| (f) | N.A. |
| 315 (a) | 7.01 |
| (b) | 7.05; 14.02 |
| (c) | 7.01 |
| (d) | 7.01 |
| (e) | 6.11 |
| 316 (a) (last sentence) | 2.08 |
| (a) (1) (A) | 6.05 |
| (a) (1) (B) | 6.04 |
| (a) (2) | N.A. |
| (b) | 6.07 |
| 317 (a) (1) | 6.08 |
| (a) (2) | 6.09 |
| (b) | 2.04 |
| 318 (a) | 14.01 |

N.A. means Not Applicable.

 * Note: This Cross Reference Table shall not, for any purpose, be deemed to be part of the Indenture.

TABLE OF CONTENTS*

| | PAGE |
|---|------|
| ARTICLE 1 | |
| DEFINITIONS AND INCORPORATION BY REFERENCE | |
| SECTION 1.01 Definitions..... | 1 |
| SECTION 1.02 Other Definitions..... | 8 |
| SECTION 1.03 Incorporation by Reference of Trust Indenture Act..... | 10 |
| SECTION 1.04 Rules of Construction..... | 10 |
| SECTION 1.05 Acts of Holders..... | 10 |
| ARTICLE 2 | |
| THE SECURITIES | |
| SECTION 2.01 Form and Dating..... | 12 |
| SECTION 2.02 Execution and Authentication..... | 13 |
| SECTION 2.03 Registrar, Paying Agent and Conversion Agent..... | 14 |
| SECTION 2.04 Paying Agent to Hold Money and Securities in Trust..... | 15 |
| SECTION 2.05 Securityholder Lists..... | 15 |
| SECTION 2.06 Transfer and Exchange..... | 15 |
| SECTION 2.07 Replacement Securities..... | 17 |
| SECTION 2.08 Outstanding Securities; Determinations of Holders' Action..... | 17 |
| SECTION 2.09 Temporary Securities..... | 18 |
| SECTION 2.10 Cancellation..... | 18 |
| SECTION 2.11 Persons Deemed Owners..... | 19 |
| SECTION 2.12 Global Securities..... | 19 |
| SECTION 2.13 CUSIP Numbers..... | 24 |
| ARTICLE 3 | |
| REDEMPTION AND PURCHASES | |
| SECTION 3.01 Right to Redeem; Notices to Trustee..... | 24 |
| SECTION 3.02 Selection of Securities to Be Redeemed..... | 24 |
| SECTION 3.03 Notice of Redemption..... | 25 |
| SECTION 3.04 Effect of Notice of Redemption..... | 26 |
| SECTION 3.05 Deposit of Redemption Price..... | 26 |
| SECTION 3.06 Securities Redeemed in Part..... | 26 |
| SECTION 3.07 Conversion Arrangement on Call for Redemption..... | 26 |
| SECTION 3.08 Purchase of Securities at Option of the Holder..... | 27 |
| SECTION 3.09 Purchase of Securities at Option of the Holder upon Change in Control..... | 33 |

 * Note: This Table of Contents shall not, for any purpose, be deemed to be part of the Indenture.

| | |
|--|----|
| SECTION 3.10 Effect of Purchase Notice or Change in Control Purchase Notice..... | 36 |
| SECTION 3.11 Deposit of Purchase Price or Change in Control Purchase Price..... | 37 |
| SECTION 3.12 Securities Purchased in Part..... | 37 |
| SECTION 3.13 Repayment to the Company..... | 38 |

ARTICLE 4 COVENANTS

| | |
|---|----|
| SECTION 4.01 Payment of Securities..... | 38 |
| SECTION 4.02 SEC and Other Reports..... | 38 |
| SECTION 4.03 Compliance Certificate..... | 39 |
| SECTION 4.04 Further Instruments and Acts..... | 39 |
| SECTION 4.05 Maintenance of Office or Agency..... | 39 |
| SECTION 4.06 Delivery of Certain Information..... | 39 |
| SECTION 4.07 Limitation on Guarantees of Indebtedness by Subsidiaries..... | 40 |
| SECTION 4.08 Covenant to Comply With Securities Laws Upon Purchase of Securities..... | 40 |
| SECTION 4.09 Calculation of Certain Amounts..... | 40 |

ARTICLE 5 SUCCESSOR CORPORATION

| | |
|---|----|
| SECTION 5.01 When Company May Merge or Transfer Assets..... | 40 |
|---|----|

ARTICLE 6 DEFAULTS AND REMEDIES

| | |
|---|----|
| SECTION 6.01 Events of Default..... | 41 |
| SECTION 6.02 Acceleration..... | 43 |
| SECTION 6.03 Other Remedies..... | 44 |
| SECTION 6.04 Waiver of Past Defaults..... | 44 |
| SECTION 6.05 Control by Majority..... | 44 |
| SECTION 6.06 Limitation on Suits..... | 45 |
| SECTION 6.07 Rights of Holders to Receive Payment..... | 45 |
| SECTION 6.08 Collection Suit by Trustee..... | 45 |
| SECTION 6.09 Trustee May File Proofs of Claim..... | 45 |
| SECTION 6.10 Priorities..... | 46 |
| SECTION 6.11 Undertaking for Costs..... | 47 |
| SECTION 6.12 Waiver of Stay, Extension or Usury Laws..... | 47 |

ARTICLE 7 TRUSTEE

| | |
|---|----|
| SECTION 7.01 Duties of Trustee..... | 47 |
| SECTION 7.02 Rights of Trustee..... | 48 |
| SECTION 7.03 Individual Rights of Trustee..... | 50 |
| SECTION 7.04 Trustee's Disclaimer..... | 50 |
| SECTION 7.05 Notice of Defaults..... | 50 |
| SECTION 7.06 Reports by Trustee to Holders..... | 50 |

ii

| | |
|---|----|
| SECTION 7.07 Compensation and Indemnity..... | 50 |
| SECTION 7.08 Replacement of Trustee..... | 51 |
| SECTION 7.09 Successor Trustee by Merger..... | 52 |
| SECTION 7.10 Eligibility; Disqualification..... | 52 |
| SECTION 7.11 Preferential Collection of Claims Against Company..... | 52 |

ARTICLE 8 DISCHARGE OF INDENTURE

| | |
|--|----|
| SECTION 8.01 Discharge of Liability on Securities..... | 52 |
| SECTION 8.02 Repayment to the Company..... | 53 |

ARTICLE 9 AMENDMENTS

| | |
|--|----|
| SECTION 9.01 Without Consent of Holders..... | 53 |
| SECTION 9.02 With Consent of Holders..... | 54 |
| SECTION 9.03 Compliance with Trust Indenture Act..... | 55 |
| SECTION 9.04 Revocation and Effect of Consents, Waivers and Actions..... | 55 |
| SECTION 9.05 Notation on or Exchange of Securities..... | 55 |
| SECTION 9.06 Trustee to Sign Supplemental Indentures..... | 55 |
| SECTION 9.07 Effect of Supplemental Indentures..... | 55 |

ARTICLE 10 SPECIAL TAX EVENT CONVERSION

| | |
|--|----|
| SECTION 10.01 Optional Conversion to Quarterly Coupon Note upon Tax Event..... | 55 |
|--|----|

ARTICLE 11 CONVERSION

| | |
|---|----|
| SECTION 11.01 Conversion Privilege..... | 56 |
| SECTION 11.02 Conversion Procedure..... | 56 |
| SECTION 11.03 Fractional Shares..... | 58 |

| | |
|---|----|
| SECTION 11.04 Taxes on Conversion..... | 58 |
| SECTION 11.05 Company to Provide Stock..... | 58 |
| SECTION 11.06 Adjustment for Change in Capital Stock..... | 58 |
| SECTION 11.07 Adjustment for Rights Issue..... | 59 |
| SECTION 11.08 Adjustment for Other Distributions..... | 60 |
| SECTION 11.09 When Adjustment May Be Deferred..... | 62 |
| SECTION 11.10 When No Adjustment Required..... | 62 |
| SECTION 11.11 Notice of Adjustment..... | 63 |
| SECTION 11.12 Voluntary Increase..... | 63 |
| SECTION 11.13 Notice of Certain Transactions..... | 63 |
| SECTION 11.14 Reorganization of Company; Special Distributions..... | 64 |
| SECTION 11.15 Company Determination Final..... | 64 |
| SECTION 11.16 Trustee's Adjustment Disclaimer..... | 65 |
| SECTION 11.17 Simultaneous Adjustments..... | 65 |

iii

| | |
|--|----|
| SECTION 11.18 Successive Adjustments..... | 65 |
| SECTION 11.19 Rights Issued in Respect of Common Stock Issued Upon Conversion..... | 65 |
| SECTION 11.20 Company's Right to Elect to Pay Cash or Common Stock..... | 65 |

ARTICLE 12 PAYMENT OF INTEREST

| | |
|--|----|
| SECTION 12.01 Interest Payments..... | 66 |
| SECTION 12.02 Defaulted Interest..... | 66 |
| SECTION 12.03 Interest Rights Preserved..... | 67 |

ARTICLE 13 SECURITY

| | |
|-----------------------------|----|
| SECTION 13.01 Security..... | 67 |
|-----------------------------|----|

ARTICLE 14 MISCELLANEOUS

| | |
|---|----|
| SECTION 14.01 Trust Indenture Act Controls..... | 69 |
| SECTION 14.02 Notices..... | 69 |
| SECTION 14.03 Communication by Holders with Other Holders..... | 70 |
| SECTION 14.04 Certificate and Opinion as to Conditions Precedent..... | 70 |
| SECTION 14.05 Statements Required in Certificate or Opinion..... | 70 |
| SECTION 14.06 Separability Clause..... | 70 |
| SECTION 14.07 Rules by Trustee, Paying Agent, Conversion Agent and Registrar..... | 70 |
| SECTION 14.08 Calculations..... | 71 |
| SECTION 14.09 Legal Holidays..... | 71 |
| SECTION 14.10 GOVERNING LAW..... | 71 |
| SECTION 14.11 No Recourse Against Others..... | 71 |
| SECTION 14.12 Successors..... | 71 |
| SECTION 14.13 Multiple Originals..... | 71 |

EXHIBITS

| | |
|-------------|--|
| Exhibit A-1 | Form of Global Security |
| Exhibit A-2 | Form of Certificate Security |
| Exhibit B-1 | Transfer Certificate |
| Exhibit B-2 | Form of Letter to be Delivered by Accredited Investors |

iv

EXECUTION COPY

INDENTURE dated as of March 21, 2003 between ALASKA AIR GROUP, INC., a Delaware corporation ("Company"), and U.S. Bank National Association, as trustee (the "Trustee").

RECITALS OF THE COMPANY

The Company has duly authorized the creation of an issue of Senior Convertible Notes due 2023 (the "Securities") having the terms, tenor, amount and other provisions hereinafter set forth, and, to provide therefor, the Company has duly authorized the execution and delivery of this Indenture.

All things necessary to make the Securities, when the Securities are duly executed by the Company and authenticated and delivered hereunder and duly issued by the Company, the valid obligations of the Company, and to make this Indenture a valid and binding agreement of the Company, in accordance with their and its terms, have been done. In addition, all things necessary to duly authorize the issuance of the Common Stock of the Company issuable upon the conversion of the Securities, and to duly reserve for issuance the number of shares of Common Stock issuable upon such conversion, have been done.

NOW, THEREFORE, THIS INDENTURE WITNESSETH:

For and in consideration of the premises and the purchase of the Securities by the Holders thereof, it is mutually covenanted and agreed, for the equal and proportionate benefit of all Holders of the Securities, as follows:

ARTICLE 1

DEFINITIONS AND INCORPORATION BY REFERENCE

SECTION 1.01 Definitions.

"144A Global Security" means a permanent Global Security in the form of the Security attached hereto as Exhibit A-1, and that is deposited with and registered in the name of the Depositary, representing Securities sold in reliance on Rule 144A under the Securities Act.

"Affiliate" of any specified person means any other person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified person. For the purposes of this definition, "control" when used with respect to any specified person means the power to direct or cause the direction of the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Applicable Procedures" means, with respect to any transfer or transaction involving a Global Security or beneficial interest therein, the rules and procedures of the Depositary for such Security, in each case to the extent applicable to such transaction and as in effect from time to time.

"Average Sale Price" means the average of the Sale Prices of the Common Stock for the shorter of

(i) 30 consecutive trading days ending on the last full trading day prior to the Time of Determination with respect to the rights, warrants or options or distribution in respect of which the Average Sale Price is being calculated, or

(ii) the period (x) commencing on the date next succeeding the first public announcement of (a) the issuance of rights, warrants or options or (b) the distribution, in each case, in respect of which the Average Sale Price is being calculated and (y) proceeding through the last full trading day prior to the Time of Determination with respect to the rights, warrants or options or distribution in respect of which the Average Sale Price is being calculated (excluding days within such period, if any, which are not trading days), or

(iii) the period, if any, (x) commencing on the date next succeeding the Ex-Dividend Time with respect to the next preceding (a) issuance of rights, warrants or options or (b) distribution, in each case, for which an adjustment is required by the provisions of Section 11.06(c), 11.07 or 11.08 and (y) proceeding through the last full trading day prior to the Time of Determination with respect to the rights, warrants or options or distribution in respect of which the Average Sale Price is being calculated (excluding days within such period, if any, which are not trading days).

In the event that the Ex-Dividend Time (or in the case of a subdivision, combination or reclassification, the effective date with respect thereto) with respect to a dividend, subdivision, combination or reclassification to which Section 11.06(a), (b), (d) or (e) applies occurs during the period applicable for calculating "Average Sale Price" pursuant to the definition in the preceding sentence, "Average Sale Price" shall be calculated for such period in a manner determined by the Board of Directors to reflect the impact of such dividend, subdivision, combination or reclassification on the Sale Price of the Common Stock during such period.

"Board of Directors" means either the board of directors of the Company or any duly authorized committee of such board.

"Business Day" means each day of the year other than a Saturday or a Sunday or other day on which banking institutions in The City of New York are

required or authorized to close.

"Capital Stock" for any corporation means any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents of or interests in (however designated) stock or other equity issued by that corporation.

"Certificated Securities" means any of the Securities that are in the form of the Securities attached hereto as Exhibit A-2.

2

"Common Stock" shall mean the shares of Common Stock, \$1.00 par value, of the Company as it exists on the date of this Indenture or any other shares of Capital Stock of the Company into which the Common Stock shall be reclassified or changed.

"Company" means the party named as the "Company" in the first paragraph of this Indenture until a successor replaces it pursuant to the applicable provisions of this Indenture and, thereafter, shall mean such successor. The foregoing sentence shall likewise apply to any subsequent such successor or successors.

"Company Request" or "Company Order" means a written request or order signed in the name of the Company by any two Officers.

"Corporate Trust Office" means the principal office of the Trustee at which at any time its corporate trust business shall be administered, which office at the date hereof is located at 101 Barclay Street, 8W, New York, New York 10286, Attention: Corporate Trust Division, or such other address as the Trustee may designate from time to time by notice to the Company, or the principal corporate trust office of any successor Trustee (or such other address as a successor Trustee may designate from time to time by notice to the Company).

"Debt" means with respect to the Company or any Subsidiary at any date, without duplication, obligations (other than nonrecourse obligations) for borrowed money or evidenced by bonds, debentures, notes or similar instruments.

"Default" means any event which is, or after notice or passage of time or both would be, an Event of Default.

"Global Securities" means any of the Securities that are in the form of the Securities attached hereto as Exhibit A-1, and to the extent that such Securities are required to bear the Legend required by Section 2.06, such Securities will be in the form of a 144A Global Security.

"Government Securities" means the direct obligations of, obligations fully guaranteed by, or participations in pools consisting solely of obligations of or obligations guaranteed by the United States of America for the payment of which guarantee or obligations the full faith and credit of the United States of America is pledged and which are not callable or redeemable at the option of the issuer thereof.

"guarantee" means, as applied to any obligation, (i) a guarantee (other than by endorsement of negotiable instruments for collection in the ordinary course of business), direct or indirect, in any manner, of any part or all of such obligation and (ii) an agreement, direct or indirect, contingent or otherwise, the practical effect of which is to assure in any way the payment or performance (or payment of damages in the event of non-performance) of all or any part of such obligation, including, without limiting the foregoing, the payment of amounts drawn down by letters of credit.

"Holder" or "Securityholder" means a person in whose name a Security is registered on the Registrar's books.

3

"Indenture" means this Indenture, as amended or supplemented from time to time in accordance with the terms hereof, including the provisions of the TIA that are deemed to be a part hereof.

"Interest Payment Date" means March 21, June 21, September 21 and December 21 of each year, commencing June 21, 2003 until (subject to Article X hereof) March 21, 2008.

"Institutional Accredited Investor Security" means a Security in the form of the Security attached hereto as Exhibit A-2, representing Securities sold to Institutional Accredited Investors.

"Issue Date" of any Security means the date on which the Security was originally issued or deemed issued as set forth on the face of the Security.

"Issue Price" of any Security means, in connection with the original issuance of such Security, the initial issue price at which the Security is sold as set forth on the face of the Security.

"Lien" means, with respect to any asset, any mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of such asset given to secure any indebtedness, whether or not filed, recorded or otherwise perfected under applicable law (including any conditional sale or other title retention agreement, any lease in the nature thereof, any option or other agreement to sell or give a security interest in and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statutes) of any jurisdiction with respect to any such lien, pledge, charge or security interest).

"Officer" means the Chairman of the Board, the Vice Chairman, the Chief Executive Officer, the President, any Executive Vice President, any Senior Vice President, any Vice President, the Treasurer or the Secretary or any Assistant Treasurer or Assistant Secretary of the Company.

"Officers' Certificate" means a written certificate containing the information specified in Sections 14.04 and 14.05, signed in the name of the Company by any two Officers, and delivered to the Trustee. An Officers' Certificate given pursuant to Section 4.03 shall be signed by the principal executive financial or accounting Officer of the Company but need not contain the information specified in Sections 14.04 and 14.05.

"Opinion of Counsel" means a written opinion containing the information specified in Sections 14.04 and 14.05, from legal counsel who is reasonably acceptable to the Trustee. The counsel may be an employee of, or counsel to, the Company or the Trustee.

"Original Principal Amount" of each Security means the original principal amount as set forth on the face of the Security.

"person" or "Person" means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, or government or any agency or political subdivision thereof.

"Pledge Account" means an account established by the Trustee pursuant to the terms of the Pledge Agreement for the deposit of the Pledged Securities purchased by the Company with a portion of the proceeds from the sale of the Securities.

"Pledge Agreement" means the Pledge Agreement, dated as of the date hereof, made by the Company in favor of the Trustee, governing the disbursement of funds from the Pledge Account, as such agreement may be amended, restated, supplemented or otherwise modified from time to time, and the term Pledge Agreement includes the Control Agreement referred to therein and contemplated thereby, as such agreement may be amended, restated, supplemented or otherwise modified from time to time.

"Pledged Securities" means the Government Securities to be purchased by the Company and held in the Pledge Account in accordance with the Pledge Agreement.

"Principal", "Principal Amount" or "principal amount" of a Security on any date means the Variable Principal Amount of such Security on such date.

"Rate/Yield Determination Date" means the second London Banking Day preceding the related Reset Date.

"Redemption Date" or "redemption date" means the date specified for redemption of the Securities in accordance with the terms of the Securities and this Indenture.

"Redemption Price" or "redemption price" shall have the meaning set forth in paragraph 6 of the Securities.

"Regular Record Date" means each March 7, June 7, September 7 and December 7 (whether or not a Business Day).

"Reset Date" means each March 21, June 21, September 21 and December 21 of each year, commencing on June 21, 2003; provided, however, that if any Reset Date would otherwise be a day that is not a Business Day, that Reset Date will be postponed to the next succeeding Business Day, except if that Business Day falls in the next succeeding calendar month, that Reset Date will be the immediately preceding Business Day.

"Responsible Officer" means, when used with respect to the Trustee, any officer within the corporate trust department of the Trustee, including any vice president, assistant vice president, assistant secretary, trust officer or any other officer of the Trustee who customarily performs functions similar to those performed by the Persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred because of such person's knowledge of and familiarity with the particular subject and who, in each case, shall have direct responsibility for the administration of this Indenture.

"Restricted Security" means a Security required to bear the restrictive legend set forth in the form of Security set forth in Exhibits A-1 and A-2 of this Indenture.

"Rule 144" means Rule 144 under the Securities Act (or any successor rule having substantially similar provisions), as it may be amended from time to time.

5

"Rule 144A" means Rule 144A under the Securities Act (or any successor rule having substantially similar provisions), as it may be amended from time to time.

"Sale Price" of Capital Stock on any date means (a) the closing per share sale price (or, if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices) on such date as reported on the NYSE or such other United States securities exchange on which the Capital Stock is traded or, if the Capital Stock is not listed on a United States national or regional securities exchange, as reported by the National Association of Securities Dealers Automated Quotation System or by the National Quotation Bureau Incorporated or (b) in the absence of such quotation, such price as the Company shall determine on the basis of such quotations as the Company considers appropriate.

"SEC" means the United States Securities and Exchange Commission.

"Securities" means any of the Company's Senior Convertible Notes due 2023, as amended or supplemented from time to time, issued under this Indenture.

"Securityholder" or "Holder" means a person in whose name a Security is registered on the Registrar's books.

"Significant Subsidiary" means "significant subsidiary", as such term is defined in Rule 1-02 of Regulation S-X under the Securities Act of 1933, as amended.

"Special Record Date" means, with respect to, the payment of any Defaulted Interest, the date fixed by the Trustee pursuant to Section 12.02.

"Stated Maturity", when used with respect to any Security, means the date specified in such Security as the final fixed date on which the Variable

Principal Amount of such Security is due and payable.

"Subsidiary" means (i) a corporation, a majority of whose Capital Stock with voting power, under ordinary circumstances, to elect directors is, at the date of determination, directly or indirectly owned by the Company, by one or more Subsidiaries of the Company or by the Company and one or more Subsidiaries of the Company, (ii) a partnership in which the Company or a Subsidiary of the Company holds a majority interest in the equity capital or profits of such partnership, or (iii) any other person (other than a corporation or a partnership) in which the Company, a Subsidiary of the Company or the Company and one or more Subsidiaries of the Company, directly or indirectly, at the date of determination, has (x) at least a majority ownership interest or (y) the power to elect or direct the election of a majority of the directors or other governing body of such person.

"Tax Event" means that the Company shall have received an opinion from independent tax counsel experienced in such matters to the effect that as a result of (a) any amendment to, or change (including any announced prospective change) in, the laws (or any regulations thereunder) of the United States or any taxing authority thereof or (b) any amendment to, or change in, an interpretation or application of such laws or regulations by any legislative body, court, governmental agency or regulatory authority, in each case which

6

amendment or change is enacted, promulgated, issued or announced or which interpretation is issued or announced or which action is taken, on or after March 18, 2003, there is more than an insubstantial risk that accruals of variable principal amount payable on the Securities either (i) would not be deductible on a current accrual basis or (ii) would not be deductible under any other method, in either case in whole or in part, by the Company (by reason of deferral, disallowance, or otherwise) for United States federal income tax purposes.

"Tax Original Issue Discount" means the amount of ordinary interest income on a Security that must be accrued as original issue discount for United States federal income tax purposes.

"TIA" means the Trust Indenture Act of 1939 as in effect on the date of this Indenture, provided, however, that in the event the TIA is amended after such date, TIA means, to the extent required by any such amendment, the TIA as so amended.

"Time of Determination" means the time and date of the earlier of (i) the determination of stockholders entitled to receive rights, warrants or options or a distribution, in each case, to which Section 11.07 or 11.08 applies and (ii) the time ("Ex-Dividend Time") immediately prior to the commencement of "ex-dividend" trading for such rights, warrants or options or distribution on the New York Stock Exchange or such other national or regional exchange or market on which the Common Stock is then listed or quoted.

"trading day" means a day during which trading in securities generally occurs on the New York Stock Exchange or, if the Common Stock is not listed on the New York Stock Exchange, on the principal other national or regional securities exchange on which the Common Stock is then listed or, if the Common Stock is not listed on a national or regional securities exchange, on the National Association of Securities Dealers Automated Quotation System or, if the Common Stock is not quoted on the National Association of Securities Dealers Automated Quotation System, on the principal other market on which the Common Stock is then traded.

"Trustee" means the party named as the "Trustee" in the first paragraph of this Indenture until a successor replaces it pursuant to the applicable provisions of this Indenture and, thereafter, shall mean such successor. The foregoing sentence shall likewise apply to any subsequent such successor or successors.

"3-month LIBOR" means, as of any Reset Date:

(a) the blended rate for 3-month deposits in United States dollars commencing on such Reset Date that appears on the Moneyline Telerate Page 3750 as of 11:00 A.M., London time, on the related Rate/Yield Determination Date, or

(b) if fewer than two source rates are used to calculate the blended rate, or no rate appears, on the particular Rate/Yield Determination Date on the Moneyline Telerate Page 3750, the rate calculated by the Calculation Agent as the arithmetic mean of at least two offered quotations obtained by the Calculation Agent after requesting the principal London offices of each of four major reference banks (which shall not include Affiliates of the Calculation Agent) in the London interbank market to provide the Calculation Agent with its offered quotation for deposits in United States dollars for the period of three months, commencing on the related Reset

7

Date, to prime banks in the London interbank market at approximately 11.00 A.M., London time, on that Rate/Yield Determination Date and in a principal amount that is representative for a single transaction in United States dollars in that market at that time, or

(c) if fewer than two offered quotations referred to in clause (b) are provided as requested, the rate calculated by the Calculation Agent as the arithmetic mean of the rates quoted at approximately 11:00 A.M., New York time, on the particular Rate/Yield Determination Date by three major banks (which shall not include Affiliates of the Calculation Agent) in The City of New York selected by the Calculation Agent for loans in United States dollars to leading European banks for a period of three months and in a principal amount that is representative for a single transaction in United States dollars in that market at that time, or

(d) if the banks so selected by the Calculation Agent are not quoting as mentioned in clause (c), the current LIBOR in effect from the previous Rate/Yield Determination Date.

For purposes of clauses (b) and (c) above, all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, with five one-millionths of a percentage point rounded upward.

"Variable Interest Rate" shall be, until June 21, 2003, 3.78625% per annum. Commencing June 21, 2003, the Variable Interest Rate shall be reset quarterly each Reset Date until March 21, 2008 to a rate of 3-month LIBOR plus 2.50% per annum. The Variable Interest Rate will be calculated using the actual number of days elapsed between the Reset Dates divided by 360.

"Variable Principal Amount" of a Security means the Original Principal Amount increased daily by the applicable Variable Yield. Until March 21, 2008, the Variable Principal Amount per \$1,000 Original Principal Amount of a Security will be equal to the Original Principal Amount of \$1,000. Commencing March 21, 2008, the Variable Principal Amount will accrue daily at the applicable Variable Yield applied to the Variable Principal Amount of the Security as of the most recent Reset Date. The Variable Principal Amount will compound quarterly, not daily.

"Variable Yield" shall, commencing March 21, 2008, be reset quarterly each Reset Date to a rate of 3-month LIBOR plus 2.50% per annum. Regardless of the level of 3-month LIBOR, the Yield shall not exceed 5.25% per annum. The Yield shall be calculated using the actual number of days elapsed between the Reset Dates divided by 360.

SECTION 1.02 Other Definitions.

| Term | Defined in |
|----------------------------|------------|
| ---- | Section |
| | ----- |
| "Act" | 1.05 (a) |
| "Agent Members" | 2.12 (f) |
| "Average Sale Price" | 11.01 |
| "Bankruptcy Law" | 6.01 |

| | |
|--|-----------|
| "beneficial owner" | 3.09 (a) |
| "Calculation Agent" | 2.03 |
| "cash" | 3.08 (b) |
| "Change in Control" | 3.09 (a) |
| "Change in Control Purchase Date" | 3.09 (a) |
| "Change in Control Purchase Notice" | 3.09 (c) |
| "Change in Control Purchase Price" | 3.09 (a) |
| "Company Notice" | 3.08 (e) |
| "Company Notice Date" | 3.08 (c) |
| "Continuing Director" | 3.09 (a) |
| "Conversion Agent" | 2.03 |
| "Conversion Date" | 11.02 |
| "Conversion Rate" | 11.01 |
| "Custodian" | 6.01 |
| "Defaulted Interest" | 12.02 |
| "Depository" | 2.01 (a) |
| "DTC" | 2.01 (a) |
| "Event of Default" | 6.01 |
| "Exchange Act" | 3.08 (d) |
| "Ex-Dividend Date" | 11.08 (b) |
| "Ex-Dividend Time" | 11.01 |
| "Extraordinary Cash Dividend" | 11.08 (a) |
| "Institutional Accredited Investors" | 2.01 (b) |
| "Legal Holiday" | 14.09 |
| "Legend" | 2.06 (f) |
| "Market Price" | 3.08 (d) |
| "Measurement Period" | 11.08 (a) |
| "noncontingent bond method" | 4.07 |
| "Notice of Default" | 6.01 |
| "Option Exercise Date" | 10.01 |
| "Paying Agent" | 2.03 |
| "Payment Default" | 6.01 (4) |
| "Post-Distribution Price" | 11.08 (b) |
| "Protected Purchaser" | 2.07 |
| "Purchase Date" | 3.08 (a) |
| "Purchase Notice" | 3.08 (a) |
| "Purchase Price" | 3.08 (a) |
| "QIBs" | 2.01 (a) |
| "Registrar" | 2.03 |
| "Relevant Cash Dividends" | 11.08 (a) |
| "Restated Principal Amount" | 10.01 |
| "Rights" | 11.19 |
| "Rights Agreement" | 11.19 |
| "Rule 144A Information" | 4.06 |
| "Securities Act" | 3.08 (d) |
| "Special Record Date" | 12.02 |

| | |
|-------------------------------|-------|
| "Tax Event Date" | 10.01 |
| "Time of Determination" | 11.01 |
| "Treasury Regulations" | 4.07 |

SECTION 1.03 Incorporation by Reference of Trust Indenture Act.
Whenever this Indenture refers to a provision of the TIA, the provision is incorporated by reference in and made a part of this Indenture. The following TIA terms used in this Indenture have the following meanings:

"Commission" means the SEC.

"indenture securities" means the Securities.

"indenture security holder" means a Securityholder.

"indenture to be qualified" means this Indenture.

"indenture trustee" or "institutional trustee" means the Trustee.

"obligor" on the indenture securities means the Company.

All other TIA terms used in this Indenture that are defined by the TIA, defined by TIA reference to another statute or defined by SEC rule have the meanings assigned to them by such definitions.

SECTION 1.04 Rules of Construction. Unless the context otherwise requires:

(1) a defined term has the meaning assigned to it;

(2) an accounting term not otherwise defined has the meaning assigned to it in accordance with United States generally accepted accounting principles as in effect from time to time;

(3) "or" is not exclusive;

(4) "including" means including, without limitation; and

(5) words in the singular include the plural, and words in the plural include the singular.

SECTION 1.05 Acts of Holders.

(a) Any request, demand, authorization, direction, notice, consent, waiver or other action provided by this Indenture to be given or taken by Holders may be embodied in and evidenced by one or more instruments (which may take the form of an electronic writing or messaging or otherwise be in accordance with customary procedures of the Depositary or the Trustee) of substantially similar tenor signed by such Holders in person or by their agent duly appointed in writing (which may be in electronic form); and, except as herein otherwise expressly provided, such action shall become effective when such instrument or instruments are

10

delivered to the Trustee and, when it is hereby expressly required, to the Company. Such instrument or instruments (and the action embodied therein and evidenced thereby) are herein sometimes referred to as the "Act" of Holders signing such instrument or instruments. Proof of execution of any such instrument or of a writing appointing any such agent (either of which may be in electronic form) shall be sufficient for any purpose of this Indenture and conclusive in favor of the Trustee and the Company, if made in the manner provided in this Section.

(b) The fact and date of the execution by any Person of any such instrument or writing may be proved by the affidavit of a witness of such execution (or electronic delivery) or by a certificate of a notary public or other officer authorized by law to take acknowledgments of deeds, certifying that the individual signing or delivering such instrument or writing acknowledged to such officer the execution (or electronic delivery) thereof. When such execution is by a signer acting in a capacity other than such signer's individual capacity, such certificate or affidavit shall also constitute sufficient proof of such signer's authority. The fact and date of the execution of any such instrument or writing (electronic or otherwise), or the authority of the Person executing the same, may also be proved in any other manner which the Trustee deems sufficient.

(c) The ownership of Securities shall be proved by the register maintained by the Registrar.

(d) Any request, demand, authorization, direction, notice, consent, waiver or other Act of the Holder of any Security shall bind every future Holder

of the same Security and the holder of every Security issued upon the registration of transfer thereof or in exchange therefor or in lieu thereof in respect of anything done, omitted or suffered to be done by the Trustee or the Company in reliance thereon, whether or not notation of such action is made upon such Security.

(e) If the Company shall solicit from the Holders any request, demand, authorization, direction, notice, consent, waiver or other Act, the Company may, at its option, by or pursuant to a resolution of the Board of Directors, fix in advance a record date for the determination of Holders entitled to give such request, demand, authorization, direction, notice, consent, waiver or other Act, but the Company shall have no obligation to do so. If such a record date is fixed, such request, demand, authorization, direction, notice, consent, waiver or other Act may be given before or after such record date, but only the Holders of record at the close of business on such record date shall be deemed to be Holders for the purposes of determining whether Holders of the requisite proportion of outstanding Securities have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other Act, and for that purpose the outstanding Securities shall be computed as of such record date; provided that no such authorization, agreement or consent by the Holders on such record date shall be deemed effective unless it shall become effective pursuant to the provisions of this Indenture within six months after the record date.

11

ARTICLE 2

THE SECURITIES

SECTION 2.01 Form and Dating. The Securities and the Trustee's certificate of authentication shall be substantially in the form of Exhibits A-1 and A-2, which are a part of this Indenture. The Securities may have notations, legends or endorsements required by law, stock exchange rule or usage (provided that any such notation, legend or endorsement required by usage is in a form acceptable to the Company). The Company shall provide any such notations, legends or endorsements to the Trustee in writing. Each Security shall be dated the date of its authentication.

(a) 144A Global Securities. Securities offered and sold within the United States to "qualified institutional buyers" as defined in Rule 144A ("QIBs") in reliance on Rule 144A shall be issued, initially in the form of a 144A Global Security, which shall be deposited with the Trustee at its Corporate Trust Office, as custodian for the Depositary and registered in the name of The Depository Trust Company ("DTC") or the nominee thereof (such depositary, or any successor thereto, and any such nominee being hereinafter referred to as the "Depository") duly executed by the Company and authenticated by the Trustee as hereinafter provided. The aggregate Original Principal Amount of the 144A Global Securities may from time to time be increased or decreased by adjustments made on the records of the Trustee and the Depositary as hereinafter provided.

(b) Institutional Accredited Investor Securities. Securities offered and sold within the United States to institutional "accredited investors" as defined in Rule 501(a)(1), (2) (3) and (7) under the Securities Act ("Institutional Accredited Investors") shall be issued, initially, in the form of an Institutional Accredited Investor Security, duly executed by the Company and authenticated by the Trustee as hereinafter provided.

(c) Global Securities in General. Except as provided in this Section 2.01, 2.06 or 2.12, owners of beneficial interests in Global Securities will not be entitled to receive physical delivery of Certificated Securities. Each Global Security shall represent such of the outstanding Securities as shall be specified therein and each shall provide that it shall represent the aggregate Original Principal Amount of outstanding Securities from time to time endorsed thereon and that the aggregate Original Principal Amount of outstanding Securities represented thereby may from time to time be reduced or increased, as appropriate, to reflect exchanges, redemptions and conversions.

Any adjustment of the aggregate Original Principal Amount of a Global Security to reflect the amount of any increase or decrease in the Original Principal Amount of outstanding Securities represented thereby shall be made by the Trustee in accordance with instructions given by the Holder thereof as required by Section 2.12 hereof and shall be made on the records of the

Trustee and the Depositary.

(d) Book-Entry Provisions. This Section 2.01(d) shall apply only to Global Securities deposited with or on behalf of the Depositary.

12

The Company shall execute and the Trustee shall, in accordance with this Section 2.01(d), authenticate and deliver initially one or more Global Securities that (a) shall be registered in the name of the Depositary, (b) shall be delivered by the Trustee to the Depositary or pursuant to the Depositary's instructions or held by the Trustee as custodian for such Depositary and (c) shall bear legends substantially to the following effect:

"UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY TO THE ISSUER OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY (AND ANY PAYMENT HEREON IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL SINCE THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

TRANSFERS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS, IN WHOLE BUT NOT IN PART, TO NOMINEES OF THE DEPOSITORY TRUST COMPANY OR TO A SUCCESSOR THEREOF OR SUCH SUCCESSOR'S NOMINEE AND TRANSFERS OF PORTIONS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS MADE IN ACCORDANCE WITH THE RESTRICTIONS SET FORTH IN ARTICLE TWO OF THE INDENTURE REFERRED TO ON THE REVERSE HEREOF."

(e) Certificated Securities. Securities not issued as interests in the Global Securities will be issued in certificated form substantially in the form of Exhibit A-2 attached hereto.

(f) U.S. Tax Legend. All Securities shall bear the following legend:

"FOR PURPOSES OF SECTIONS 1272, 1273 AND 1275 OF THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED, THIS SECURITY IS ISSUED WITH AN INDETERMINATE AMOUNT OF ORIGINAL ISSUE DISCOUNT FOR UNITED STATES FEDERAL INCOME TAX PURPOSES. THE ISSUE DATE IS MARCH 21, 2003, AND THE YIELD TO MATURITY BASED ON A FIXED RATE EQUIVALENT FOR PURPOSES OF ACCRUING ORIGINAL ISSUE DISCOUNT IS 3.78625% PER ANNUM."

SECTION 2.02 Execution and Authentication. The Securities shall be executed on behalf of the Company by any Officer. The signature of the Officer on the Securities may be manual or facsimile.

13

Securities bearing the manual or facsimile signatures of an individual who was at the time of the execution of the Securities the proper Officer of the Company shall bind the Company, notwithstanding that such individual has ceased to hold such office prior to the authentication and delivery of such Securities or did not hold such office at the date of authentication of such Securities.

No Security shall be entitled to any benefit under this Indenture or be valid or obligatory for any purpose unless there appears on such Security a certificate of authentication substantially in the form provided for herein duly executed by the Trustee by manual signature of an authorized signatory of the Trustee and such certificate upon any Security shall be conclusive evidence, and the only evidence, that such Security has been duly authenticated and delivered hereunder.

The Trustee shall authenticate and deliver Securities for original issue in an aggregate Original Principal Amount of up to \$175,000,000 upon one or more Company Orders without any further action by the Company. The aggregate Original Principal Amount of Securities outstanding at any time may not exceed the amount set forth in the foregoing sentence, except as provided in Section

The Securities shall be issued only in registered form without coupons and only in denominations of \$1,000 of Original Principal Amount and any integral multiple thereof.

SECTION 2.03 Registrar, Paying Agent and Conversion Agent. The Company shall maintain an office or agency where Securities may be presented for registration of transfer or for exchange ("Registrar"), an office or agency where Securities may be presented for purchase or payment ("Paying Agent"), an office or agency where all calculations in respect of the Securities shall be made ("Calculation Agent"), and an office or agency where Securities may be presented for conversion ("Conversion Agent"). The Registrar shall keep a register of the Securities and of their transfer and exchange. The Company may have one or more co-registrars, one or more additional paying agents and one or more additional conversion agents. The term Paying Agent includes any additional paying agent, including any named pursuant to Section 4.05. The term Conversion Agent includes any additional conversion agent, including any named pursuant to Section 4.05.

The Company shall enter into an appropriate agency agreement with any Registrar or co-registrar, Paying Agent or Conversion Agent (other than the Trustee). The agreement shall implement the provisions of this Indenture that relate to such agent. The Company shall notify the Trustee of the name and address of any such agent. If the Company fails to maintain a Registrar, Paying Agent or Conversion Agent, the Trustee shall act as such and shall be entitled to appropriate compensation therefor pursuant to Section 7.07. The Company or any Subsidiary or an Affiliate of either of them may act as Paying Agent, Registrar, Conversion Agent or co-registrar.

The Company initially appoints the Trustee as Calculation Agent, Registrar, Conversion Agent and Paying Agent in connection with the Securities.

SECTION 2.04 Paying Agent to Hold Money and Securities in Trust. Except as otherwise provided herein, not later than 10:00 a.m., New York City time, on each due date of payments in respect of any Security, the Company shall deposit with the Paying Agent a sum of money (in immediately available funds if deposited on the due date) or Common Stock sufficient to make such payments when so becoming due. The Company shall require each Paying Agent (other than the Trustee) to agree in writing that the Paying Agent shall hold in trust for the benefit of Securityholders or the Trustee all money and Common Stock held by the Paying Agent for the making of payments in respect of the Securities and shall notify the Trustee of any default by the Company in making any such payment. At any time during the continuance of any such default, the Paying Agent shall, upon the written request of the Trustee, forthwith pay to the Trustee all money and Common Stock so held in trust. If the Company, a Subsidiary or an Affiliate of either of them acts as Paying Agent, it shall segregate the money and Common Stock held by it as Paying Agent and hold it as a separate trust fund. The Company at any time may require a Paying Agent to pay all money and Common Stock held by it to the Trustee and to account for any funds and Common Stock disbursed by it. Upon doing so, the Paying Agent shall have no further liability for the money or Common Stock.

SECTION 2.05 Securityholder Lists. The Trustee shall preserve in as current a form as is reasonably practicable the most recent list available to it of the names and addresses of Securityholders. If the Trustee is not the Registrar, the Company shall cause to be furnished to the Trustee at least quarterly on March 1, June 1, September 1 and December 1 a listing of Securityholders dated within 15 days of the date on which the list is furnished and at such other times as the Trustee may request in writing a list in such form and as of such date as the Trustee may reasonably require of the names and addresses of Securityholders.

SECTION 2.06 Transfer and Exchange. Subject to Section 2.12 hereof,

(a) Upon surrender for registration of transfer of any Security, together with a written instrument of transfer satisfactory to the Registrar duly executed by the Securityholder or such Securityholder's attorney duly authorized in writing, at the office or agency of the Company designated as Registrar or co-registrar pursuant to Section 2.03, the Company shall execute, and the Trustee upon receipt of a Company Order shall authenticate and deliver,

in the name of the designated transferee or transferees, one or more new Securities of any authorized denomination or denominations, of a like aggregate Original Principal Amount. The Company shall not charge a service charge for any registration of transfer or exchange, but the Company may require payment of a sum sufficient to pay all taxes, assessments or other governmental charges that may be imposed in connection with the registration of transfer or exchange of the Securities from the Securityholder requesting such registration of transfer or exchange.

At the option of the Holder, Certificated Securities may be exchanged for other Securities of any authorized denomination or denominations, of a like aggregate Original Principal Amount, upon surrender of the Securities to be exchanged, together with a written instrument of transfer satisfactory to the Registrar duly executed by the Securityholder or such Securityholder's attorney duly authorized in writing, at such office or agency. Whenever any Securities are so surrendered for exchange, the Company shall execute, and the Trustee upon receipt of a Company Order shall authenticate and deliver, the Securities which the Holder making the exchange is entitled to receive.

15

The Company shall not be required to make, and the Registrar need not register, transfers or exchanges of Securities selected for redemption (except, in the case of Securities to be redeemed in part, the portion thereof not to be redeemed) or any Securities in respect of which a Purchase Notice or Change in Control Purchase Notice has been given and not withdrawn by the Holder thereof in accordance with the terms of this Indenture (except, in the case of Securities to be purchased in part, the portion thereof not to be purchased) or any Securities for a period of 15 days before the mailing of a notice of redemption of Securities to be redeemed.

(b) Notwithstanding any provision to the contrary herein, so long as a Global Security remains outstanding and is held by or on behalf of the Depositary, transfers of a Global Security, in whole or in part, shall be made only in accordance with Section 2.12 and this Section 2.06(b). Transfers of a Global Security shall be limited to transfers of such Global Security in whole, or in part, to nominees of the Depositary or to a successor of the Depositary or such successor's nominee.

(c) Successive registrations and registrations of transfers and exchanges as aforesaid may be made from time to time as desired, and each such registration shall be noted on the register for the Securities.

(d) Any Registrar appointed pursuant to Section 2.03 hereof shall provide to the Trustee such information as the Trustee may reasonably require in connection with the delivery by such Registrar of Securities upon registration of transfer or exchange of Securities.

(e) No Registrar shall be required to make registrations of transfer or exchange of Securities during any periods designated in the text of the Securities or in this Indenture as periods during which such registration of transfers and exchanges need not be made.

(f) If Securities are issued upon the registration of transfer, exchange or replacement of Securities subject to restrictions on transfer and bearing the legends set forth on the form of Security attached hereto as Exhibits A-1 and A-2 setting forth such restrictions (collectively, the "Legend"), or if a request is made to remove the Legend on a Security, the Securities so issued shall bear the Legend, or the Legend shall not be removed, as the case may be, unless there is delivered to the Company and the Registrar such satisfactory evidence, which shall include an Opinion of Counsel, as may be reasonably required by the Company and the Registrar, that neither the Legend nor the restrictions on transfer set forth therein are required to ensure that transfers thereof comply with the provisions of Rule 144A or Rule 144 or that such Securities are not "restricted" within the meaning of Rule 144. Upon (i) provision of such satisfactory evidence, or (ii) notification by the Company to the Trustee and Registrar of the sale of such Security pursuant to a registration statement that is effective at the time of such sale, the Trustee, upon receipt of a Company Order, shall authenticate and deliver a Security that does not bear the Legend. If the Legend is removed from the face of a Security and the Security is subsequently held by an Affiliate of the Company, the Company shall use its reasonable best efforts to reinstate the Legend.

The Trustee and the Registrar shall have no obligation or duty to monitor, determine or inquire as to compliance with any restrictions on transfer imposed under this Indenture or under applicable law with respect to any transfer of any interest in any Security

16

(including any transfers between or among Depositary participants or beneficial owners of interests in any Global Security) other than to require delivery of such certificates and other documentation or evidence as are expressly required by, and to do so if and when expressly required by the terms of, this Indenture, and to examine the same to determine substantial compliance as to form with the express requirements hereof.

SECTION 2.07 Replacement Securities. If (a) any mutilated Security is surrendered to the Trustee, or (b) the Company and the Trustee receive evidence to their satisfaction of the destruction, loss or theft of any Security, and there is delivered to the Company and the Trustee such security or indemnity as may be required by them to save each of them harmless, then, in the absence of notice to the Company or the Trustee that such Security has been acquired by a protected purchaser within the meaning of Article 8 of the Uniform Commercial Code (a "Protected Purchaser"), the Company shall execute and upon receipt of a Company Order, the Trustee shall authenticate and deliver, in exchange for any such mutilated Security or in lieu of any such destroyed, lost or stolen Security, a new Security of like tenor and Original Principal Amount, bearing a number not contemporaneously outstanding.

In case any such mutilated, destroyed, lost or stolen Security has become or is about to become due and payable, or is about to be purchased by the Company pursuant to Article 3 hereof, the Company in its discretion may, instead of issuing a new Security, pay or purchase such Security, as the case may be.

Upon the issuance of any new Securities under this Section, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Trustee) in connection therewith.

Every new Security issued pursuant to this Section in lieu of any mutilated, destroyed, lost or stolen Security shall constitute an original additional contractual obligation of the Company, whether or not the destroyed, lost or stolen Security shall be at any time enforceable by anyone, and shall be entitled to all benefits of this Indenture equally and proportionately with any and all other Securities duly issued hereunder.

The provisions of this Section are exclusive and shall preclude (to the extent lawful) all other rights and remedies with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities.

SECTION 2.08 Outstanding Securities; Determinations of Holders' Action. Securities outstanding at any time are all the Securities authenticated by the Trustee, except for those cancelled by it, those paid pursuant to Section 2.10 and delivered to it for cancellation and those described in this Section 2.08 as not outstanding. A Security does not cease to be outstanding because the Company or an Affiliate thereof holds the Security; provided, however, that in determining whether the Holders of the requisite Original Principal Amount of Securities have given or concurred in any request, demand, authorization, direction, notice, consent or waiver hereunder, Securities owned by the Company or any other obligor upon the Securities or any Affiliate of the Company or such other obligor shall be disregarded and deemed not to be outstanding, except that, in determining whether the Trustee shall be protected in relying upon

17

any such request, demand, authorization, direction, notice, consent or waiver, only Securities which a Responsible Officer of the Trustee actually knows to be so owned shall be so disregarded. Subject to the foregoing, only Securities outstanding at the time of such determination shall be considered in any such determination (including, without limitation, determinations pursuant to Articles 6 and 9).

If a Security is replaced pursuant to Section 2.07, the replaced Security ceases to be outstanding unless the Trustee and the Company receive proof satisfactory to each of them that the replaced Security is held by a Protected Purchaser unaware that such Security has been replaced, in which case the replacement security shall be deemed not to be outstanding.

If the Paying Agent holds, in accordance with this Indenture, on a Redemption Date, or on the Business Day following the Purchase Date or a Change in Control Purchase Date, or on Stated Maturity, money or securities, if permitted hereunder, sufficient to pay Securities payable on that date, then immediately after such Redemption Date, Purchase Date, Change in Control Purchase Date or Stated Maturity, as the case may be, such Securities shall cease to be outstanding and the Variable Principal Amount of such Securities, shall cease to increase, and cash interest (if any) on such Securities shall cease to accrue; provided, that if such Securities are to be redeemed, notice of such redemption has been duly given pursuant to this Indenture.

If a Security is converted in accordance with Article 11, then from and after the time of conversion on the Conversion Date, such Security shall cease to be outstanding and the Variable Principal Amount of such Security shall cease to increase, and cash interest (if any) shall cease to accrue on such Security.

SECTION 2.09 Temporary Securities. Pending the preparation of definitive Securities, the Company may execute, and upon Company Order, the Trustee shall authenticate and deliver, temporary Securities which are printed, lithographed, typewritten, mimeographed or otherwise produced, in any authorized denomination, substantially of the tenor of the definitive Securities in lieu of which they are issued and with such appropriate insertions, omissions, substitutions and other variations as the officers executing such Securities may determine, as conclusively evidenced by their execution of such Securities.

If temporary Securities are issued, the Company will cause definitive Securities to be prepared without unreasonable delay. After the preparation of definitive Securities, the temporary Securities shall be exchangeable for definitive Securities upon surrender of the temporary Securities at the office or agency of the Company designated for such purpose pursuant to Section 2.03, without charge to the Holder. Upon surrender for cancellation of any one or more temporary Securities the Company shall execute and upon Company Order the Trustee shall authenticate and deliver in exchange therefor a like Original Principal Amount of definitive Securities of authorized denominations. Until so exchanged the temporary Securities shall in all respects be entitled to the same benefits under this Indenture as definitive Securities.

SECTION 2.10 Cancellation. All Securities surrendered for payment, purchase by the Company pursuant to Article 3, conversion, redemption or registration of transfer or exchange shall, if surrendered to any person other than the Trustee, be delivered to the Trustee and shall be promptly cancelled by it. The Company may at any time deliver to the Trustee for

18

cancellation any Securities previously authenticated and delivered hereunder which the Company may have acquired in any manner whatsoever, and all Securities so delivered shall be promptly cancelled by the Trustee. The Company may not issue new Securities to replace Securities it has paid or delivered to the Trustee for cancellation or that any Holder has converted pursuant to Article 11. No Securities shall be authenticated in lieu of or in exchange for any Securities cancelled as provided in this Section, except as expressly permitted by this Indenture. All cancelled Securities held by the Trustee shall be disposed of by the Trustee.

SECTION 2.11 Persons Deemed Owners. Prior to due presentment of a Security for registration of transfer, the Company, the Trustee and any agent of the Company or the Trustee may treat the Person in whose name such Security is registered as the owner of such Security for the purpose of receiving payment of principal of the Security or the payment of any Redemption Price, Purchase Price or Change in Control Purchase Price in respect thereof or cash interest thereon, for the purpose of conversion and for all other purposes whatsoever, whether or not such Security be overdue, and neither the Company, the Trustee nor any agent of the Company or the Trustee shall be affected by notice to the contrary.

SECTION 2.12 Global Securities.

(a) Notwithstanding any other provisions of this Indenture or the Securities, (A) transfers of a Global Security, in whole or in part, shall be made only in accordance with Section 2.06 and Section 2.12(b)(i) below, (B) transfer of a beneficial interest in a Global Security for a Certificated Security shall comply with Section 2.06 and Section 2.12(b)(i) below, and (C) transfers of a Certificated Security shall comply with Section 2.06 and Section 2.12(b)(ii) and transfer of a Certificated Security for a Beneficial Interest in a Global Security shall comply with Section 2.06 and Section 2.12(b)(iii) below.

(b) Transfer of Global Security. A Global Security may not be transferred, in whole or in part, to any Person other than the Depositary or a nominee or any successor thereof, and no such transfer to any such other Person may be registered; provided that this Section 2.12(b)(i) shall not prohibit any transfer of a Security that is issued in exchange for a Global Security but is not itself a Global Security. No transfer of a Security to any Person shall be effective under this Indenture or the Securities unless and until such Security has been registered in the name of such Person. Nothing in this Section 2.12(b)(i) shall prohibit or render ineffective any transfer of a beneficial interest in a Global Security effected in accordance with the other provisions of this Section 2.12(b).

(i) Restrictions on Transfer of a Beneficial Interest in a Global Security for a Certificated Security. A beneficial interest in a Global Security may not be exchanged for a Certificated Security except upon satisfaction of the requirements set forth below. Upon receipt by the Trustee of a request for transfer of a beneficial interest in a Global Security in accordance with Applicable Procedures for a Certificated Security in the form satisfactory to the Trustee, together with:

- (A) so long as the Securities are Restricted Securities, certification, in the form set forth in Exhibit B-1, and, if requested by the Company or the Registrar, certification in the form set forth in Exhibit B-2, that such beneficial

19

interest in the Global Security is being transferred to an Institutional Accredited Investor that satisfies the definitions set forth in subparagraphs (a)(1), (2), (3) or (7) of Rule 501 under the Securities Act;

- (B) written instructions to the Trustee to make, or direct the Registrar to make, an adjustment on its books and records with respect to such Global Security to reflect a decrease in the aggregate Original Principal Amount of the Securities represented by the Global Security, such instructions to contain information regarding the Depositary account to be credited with such decrease; and
- (C) if the Company or Registrar so requests, an Opinion of Counsel or other evidence reasonably satisfactory to them as to the compliance with the restrictions set forth in the Legend,

then the Trustee shall cause, or direct the Registrar to cause, in accordance with the standing instructions and procedures existing between the Depositary and the Registrar, the aggregate Original Principal Amount of Securities represented by the Global Security to be decreased by the aggregate Original Principal Amount of the Certificated Security to be issued, shall authenticate and deliver such Certificated Security and shall debit or cause to be debited to the account of the Person specified in such instructions a beneficial interest in the Global Security equal to the Original Principal Amount of the Certificated Security so issued.

(ii) Transfer and Exchange of Certificated Securities. When Certificated Securities are presented to the Registrar with a request:

- (x) to register the transfer of such Certificated Securities; or
- (y) to exchange such Certificated Securities for an equal

Original Principal Amount of Certificated Securities of other authorized denominations,

the Registrar shall register the transfer or make the exchange as requested if its reasonable requirements for such transaction are met; provided, however, that the Certificated Securities surrendered for registration of transfer or exchange:

(A) shall be duly endorsed or accompanied by a written instrument of transfer in form reasonably satisfactory to the Company and the Registrar, duly executed by the Holder thereof or his attorney duly authorized in writing; and

(B) so long as such Securities are Restricted Securities, such Securities are being transferred or exchanged pursuant to an effective registration statement under the Securities Act or, if being transferred pursuant to clause (1), (2) or (3) below, are accompanied by the additional information and documents specified in each clause, as applicable:

20

(1) if such Certificated Securities are being delivered to the Registrar by a Holder for registration in the name of such Holder, without transfer, a certification from such Holder to that effect; or

(2) if such Certificated Securities are being transferred to the Company, a certification to that effect; or

(3) if such Certificated Securities are being transferred pursuant to an exemption from registration (i) a certification to that effect (in the form set forth in Exhibit B-1 and B-2, if applicable) and (ii) if the Company or Registrar so requests, an opinion of counsel or other evidence reasonably satisfactory to them as to the compliance with the restrictions set forth in the Legend.

(iii) Restrictions on Transfer of a Certificated Security for a Beneficial Interest in a Global Security. A Certificated Security may not be exchanged for a beneficial interest in a Global Security except upon satisfaction of the requirements set forth below.

Upon receipt by the Trustee of a Certificated Security, duly endorsed or accompanied by appropriate instruments of transfer, in form satisfactory to the Trustee, together with:

(A) so long as the Securities are Restricted Securities, certification, in the form set forth in Exhibit B-1, that such Certificated Security is being transferred to a QIB in accordance with Rule 144A; and

(B) written instructions directing the Trustee to make, or to direct the Registrar to make, an adjustment on its books and records with respect to such Global Security to reflect an increase in the aggregate Original Principal Amount of the Securities represented by the Global Security, such instructions to contain information regarding the Depositary account to be credited with such increase,

then the Trustee shall cancel such Certificated Security and cause, or direct the Registrar to cause, in accordance with the standing instructions and procedures existing between the Depositary and the Registrar, the aggregate Original Principal Amount of Securities represented by the Global Security to be increased by the aggregate Original Principal Amount of the Certificated Security to be exchanged, and shall credit or cause to be credited to the account of the Person specified in such instructions a beneficial interest in the Global Security equal to the Original Principal Amount of the Certificated Security so cancelled. If no Global Securities are then outstanding, the Company shall issue and the Trustee, upon receipt of a Company Order, shall authenticate a new Global Security in the

appropriate Original Principal Amount.

(c) Subject to the succeeding paragraph, every Security shall be subject to the restrictions on transfer provided in the Legend including the requirement of the delivery of an

21

Opinion of Counsel, if so provided. Whenever any Restricted Security is presented or surrendered for registration of transfer or for exchange for a Security registered in a name other than that of the Holder, such Security must be accompanied by a certificate in substantially the form set forth in Exhibit B-1, dated the date of such surrender and signed by the Holder of such Security, as to compliance with such restrictions on transfer. The Registrar shall not be required to accept for such registration of transfer or exchange any Security not so accompanied by a properly completed certificate.

(d) The restrictions imposed by the Legend upon the transferability of any Security shall cease and terminate when such Security has been sold pursuant to an effective registration statement under the Securities Act or transferred in compliance with Rule 144 or, if earlier, upon the expiration of the holding period applicable to sales thereof under paragraph (k) of Rule 144. Any Security as to which such restrictions on transfer shall have expired in accordance with their terms or shall have terminated may, upon a surrender of such Security for exchange to the Registrar in accordance with the provisions of this Section 2.12 (accompanied, in the event that such restrictions on transfer have terminated by reason of a transfer in compliance with Rule 144, by an opinion of counsel having substantial experience in practice under the Securities Act and otherwise reasonably acceptable to the Company, addressed to the Company, the Trustee and the Registrar and in form acceptable to the Company, to the effect that the transfer of such Security has been made in compliance with Rule 144), be exchanged for a new Security, of like tenor and aggregate Original Principal Amount, which shall not bear the restrictive Legend. The Company shall inform the Trustee of the effective date of any registration statement registering the Securities under the Securities Act. The Trustee and the Registrar shall not be liable for any action taken or omitted to be taken by it in good faith in accordance with the aforementioned opinion of counsel or registration statement.

(e) As used in the preceding two paragraphs of this Section 2.12, the term "transfer" encompasses any sale, pledge, transfer, hypothecation or other disposition of any Security.

(f) The provisions of clauses (1), (2), (3), (4) and (5) below shall apply only to Global Securities:

(1) Notwithstanding any other provisions of this Indenture or the Securities, except as provided in Section 2.12(b)(i), a Global Security shall not be exchanged in whole or in part for a Security registered in the name of any Person other than the Depositary or one or more nominees thereof, provided that a Global Security may be exchanged for Securities registered in the names of any person designated by the Depositary in the event that (i) the Depositary has notified the Company that it is unwilling or unable to continue as Depositary for such Global Security or such Depositary has ceased to be a "clearing agency" registered under the Exchange Act, and a successor Depositary is not appointed by the Company within 90 days; (ii) the Company elects to discontinue use of the system of book-entry transfer through DTC (or any successor depositary); or (iii) an Event of Default has occurred and is continuing with respect to the Securities. Any Global Security exchanged pursuant to clause (i) of

22

this sub-section shall be so exchanged in whole and not in part, and any Global Security exchanged pursuant to clause (ii) of this sub-section may be exchanged in whole or from time to time in part as directed by the Depositary. Any Security issued in exchange for a Global Security or any

portion thereof shall be a Global Security; provided that any such Security so issued that is registered in the name of a person other than the Depositary or a nominee thereof shall not be a Global Security.

(2) Securities issued in exchange for a Global Security or any portion thereof shall be issued in definitive, fully registered form, without interest coupons, shall have an aggregate Original Principal Amount equal to that of such Global Security or portion thereof to be so exchanged, shall be registered in such names and be in such authorized denominations as the Depositary shall designate and shall bear the applicable legends provided for herein. Any Global Security to be exchanged in whole shall be surrendered by the Depositary to the Trustee, as Registrar. With regard to any Global Security to be exchanged in part, either such Global Security shall be so surrendered for exchange or, if the Trustee is acting as custodian for the Depositary or its nominee with respect to such Global Security, the Original Principal Amount thereof shall be reduced, by an amount equal to the portion thereof to be so exchanged, by means of an appropriate adjustment made on the records of the Trustee. Upon any such surrender or adjustment, the Trustee shall authenticate and deliver the Security issuable on such exchange to or upon the order of the Depositary or an authorized representative thereof.

(3) Subject to the provisions of clause (5) below, the registered Holder may grant proxies and otherwise authorize any Person, including Agent Members (as defined below) and persons that may hold interests through Agent Members, to take any action which a holder is entitled to take under this Indenture or the Securities.

(4) In the event of the occurrence of any of the events specified in clause (1) above, the Company will promptly make available to the Trustee a reasonable supply of Certificated Securities in definitive, fully registered form, without interest coupons.

(5) Neither any members of, or participants in, the Depositary (collectively, the "Agent Members") nor any other Persons on whose behalf Agent Members may act shall have any rights under this Indenture with respect to any Global Security registered in the name of the Depositary or any nominee thereof, or under any such Global Security, and the Depositary or such nominee, as the case may be, may be treated by the Company, the Trustee and any agent of the Company or the Trustee as the absolute owner and holder of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall prevent the Company, the Trustee or any agent of the Company or the Trustee

23

from giving effect to any written certification, proxy or other authorization furnished by the Depositary or such nominee, as the case may be, or impair, as between the Depositary, its Agent Members and any other person on whose behalf an Agent Member may act, the operation of customary practices of such Persons governing the exercise of the rights of a holder of any Security.

SECTION 2.13 CUSIP Numbers. The Company in issuing the Securities may use "CUSIP" numbers (if then generally in use), and, if so, the Trustee shall use "CUSIP" numbers in notices of redemption as a convenience to Holders; provided that any such notice may state that no representation is made as to the correctness of such numbers either as printed on the Securities or as contained in any notice of a redemption and that reliance may be placed only on the other identification numbers printed on the Securities, and any such redemption shall not be affected by any defect in or omission of such numbers. The Company will promptly notify the Trustee of any change in the CUSIP numbers.

ARTICLE 3

REDEMPTION AND PURCHASES

SECTION 3.01 Right to Redeem; Notices to Trustee. The Company, at its option, may redeem the Securities in accordance with the provisions of paragraphs 6 and 8 of the Securities. Prior to March 21, 2006, the Company cannot redeem the Securities. Beginning on March 21, 2006, the Company may redeem the Securities for cash in whole at any time, or in part from time to time. If the Company elects to redeem Securities pursuant to paragraph 6 of the Securities, it shall notify the Trustee in writing of the Redemption Date, the Original Principal Amount of Securities to be redeemed, the Redemption Price and the amount of accrued and unpaid cash interest, if any, payable on the Redemption Date.

The Company shall give the notice to the Trustee provided for in this Section 3.01 by a Company Order, at least 45 days before the Redemption Date (unless a shorter notice shall be satisfactory to the Trustee). If fewer than all the Securities are to be redeemed, the record date relating to such redemption shall be selected by the Company and given to the Trustee, which record date shall not be less than ten days after the date of notice to the Trustee.

SECTION 3.02 Selection of Securities to Be Redeemed. If less than all the Securities are to be redeemed, the Trustee shall select the Securities to be redeemed pro rata or by lot or by any other method the Trustee considers fair and appropriate (so long as such method is not prohibited by the rules of any stock exchange on which the Securities are then listed). The Trustee shall make the selection at least 30 days but not more than 60 days before the Redemption Date from outstanding Securities not previously called for redemption.

Securities and any portions thereof that the Trustee selects shall be in Original Principal Amounts of \$1,000 or an integral multiple of \$1,000. Provisions of this Indenture that apply to Securities called for redemption also apply to portions of Securities called for redemption. The Trustee shall notify the Company promptly of the Securities or portions of Securities to be redeemed.

24

If any Security selected for partial redemption is converted in part before termination of the conversion right with respect to the portion of the Security so selected, the converted portion of such Security shall be deemed (so far as may be) to be the portion selected for redemption. Securities which have been converted during a selection of Securities to be redeemed may be treated by the Trustee as outstanding for the purpose of such selection.

SECTION 3.03 Notice of Redemption. At least 30 days but not more than 60 days before a Redemption Date, the Company shall mail a notice of redemption by first-class mail, postage prepaid, to each Holder of Securities to be redeemed.

The notice shall identify the Securities to be redeemed and shall state:

- (1) the Redemption Date;
- (2) the Redemption Price and accrued and unpaid cash interest, if any, payable on the Redemption Date;
- (3) the Conversion Rate;
- (4) the name and address of the Paying Agent and Conversion Agent;
- (5) that Securities called for redemption may be converted at any time before the close of business on the second Business Day immediately preceding the Redemption Date, even if not otherwise convertible at such time;
- (6) that Holders who want to convert Securities must satisfy the requirements set forth in paragraph 9 of the Securities;
- (7) that Securities called for redemption must be surrendered to the

Paying Agent to collect the Redemption Price and accrued and unpaid cash interest, if any;

(8) if fewer than all the outstanding Securities are to be redeemed, the certificate number and Original Principal Amounts of the particular Securities to be redeemed;

(9) that, unless the Company defaults in making payment of such Redemption Price and any cash interest which is due and payable, the Variable Principal Amount will cease to increase and cash interest (if any) will cease to accrue on and after the Redemption Date;

(10) the CUSIP number of the Securities; and

(11) any other information the Company wants to present.

At the Company's request, the Trustee shall give the notice of redemption to Holders in the Company's name and at the Company's expense, provided that the Company

25

makes such request at least five Business Days (unless a shorter period shall be satisfactory to the Trustee) prior to the date such notice of redemption must be mailed.

SECTION 3.04 Effect of Notice of Redemption. Once notice of redemption is given, Securities called for redemption become due and payable on the Redemption Date and at the Redemption Price (together with accrued and unpaid cash interest, if any, to but not including the date of redemption) stated in the notice except for Securities which are converted in accordance with the terms of this Indenture. Upon surrender to the Paying Agent, such Securities shall be paid at the Redemption Price (together with accrued and unpaid cash interest, if any, to but not including the date of redemption) stated in the notice.

SECTION 3.05 Deposit of Redemption Price. Prior to 10:00 a.m. (New York City time), on any Redemption Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of either of them is the Paying Agent, shall segregate and hold in trust) money sufficient to pay the Redemption Price of, and any accrued and unpaid interest to but not including the date of redemption with respect to, all Securities to be redeemed on that date other than Securities or portions of Securities called for redemption which on or prior thereto have been delivered by the Company to the Trustee for cancellation or have been converted. The Paying Agent shall as promptly as practicable return to the Company any money not required for that purpose because of conversion of Securities pursuant to Article 11. If such money is then held by the Company in trust and is not required for such purpose it shall be discharged from such trust.

SECTION 3.06 Securities Redeemed in Part. Upon surrender of a Security that is redeemed in part, the Company shall execute and the Trustee shall authenticate and deliver to the Holder a new Security in an authorized denomination equal in Original Principal Amount to the unredeemed portion of the Security surrendered.

SECTION 3.07 Conversion Arrangement on Call for Redemption. In connection with any redemption of Securities, the Company may arrange for the purchase and conversion of any Securities called for redemption by an agreement with one or more investment banks or other purchasers to purchase such Securities by paying to the Trustee in trust for the Securityholders, on or prior to 10:00 a.m. New York City time on the Redemption Date, an amount that, together with any amounts deposited with the Trustee by the Company for the redemption of such Securities, is not less than the Redemption Price of, and any accrued and unpaid interest with respect to, such Securities. Notwithstanding anything to the contrary contained in this Article 3, the obligation of the Company to pay the Redemption Prices of such Securities shall be deemed to be satisfied and discharged to the extent such amount is so paid by such purchasers. If such an agreement is entered into, any Securities not duly surrendered for conversion by the Holders thereof may, at the option of the Company, be deemed, to the fullest extent permitted by law, acquired by such purchasers from such Holders and (notwithstanding anything to the contrary contained in Article 11) surrendered by such purchasers for conversion, all as

of immediately prior to the close of business on the Business Day prior to the Redemption Date, subject to payment of the above amount as aforesaid. The Trustee shall hold and pay to the Holders whose Securities are selected for redemption any such amount paid to it for purchase and conversion in the same manner as it would moneys deposited with it by the Company for the redemption of Securities. Without the Trustee's prior written consent, no arrangement between

26

the Company and such purchasers for the purchase and conversion of any Securities shall increase or otherwise affect any of the powers, duties, responsibilities or obligations of the Trustee as set forth in this Indenture, and the Company agrees to indemnify the Trustee from, and hold it harmless against, any loss, liability or expense arising out of or in connection with any such arrangement for the purchase and conversion of any Securities between the Company and such purchasers, including the costs and expenses incurred by the Trustee in the defense of any claim or liability arising out of or in connection with the exercise or performance of any of its powers, duties, responsibilities or obligations under this Indenture.

SECTION 3.08 Purchase of Securities at Option of the Holder

(a) General. Securities shall be purchased by the Company pursuant to paragraph 7 of the Securities as of March 21, 2008, 2013 and 2018 (each, a "Purchase Date"), at a purchase price equal to the Variable Principal Amount of the Securities on the applicable Purchase Date plus accrued and unpaid cash interest, if any, (the "Purchase Price"), at the option of the Holder thereof, upon:

(1) delivery to the Paying Agent, by the Holder of a written notice of purchase (a "Purchase Notice") at any time from the opening of business on the date that is 20 Business Days prior to a Purchase Date until the close of business on such Purchase Date stating:

(A) the certificate numbers of the Securities which the Holder will deliver to be purchased,

(B) the portion of the Original Principal Amount of the Securities which the Holder will deliver to be purchased, which portion must be an Original Principal Amount of \$1,000 or an integral multiple thereof,

(C) that such Security shall be purchased as of the Purchase Date pursuant to the terms and conditions specified in paragraph 7 of the Securities and in this Indenture, and

(D) in the event the Company elects, pursuant to Section 3.08(b), to pay the Purchase Price to be paid as of such Purchase Date, in whole or in part, in shares of Common Stock but such portion of the Purchase Price shall ultimately be payable to such Holder entirely in cash because any of the conditions to payment of the Purchase Price in Common Stock is not satisfied prior to the close of business on such Purchase Date, as set forth in Section 3.08(d), whether such Holder elects (i) to withdraw such Purchase Notice as to some or all of the Securities to which such Purchase Notice relates (stating the Original Principal Amount and certificate numbers of the Securities as to which such withdrawal shall relate), or (ii) to receive cash in respect of the entire Purchase Price for all Securities (or portions thereof) to which such Purchase Notice relates; and

(2) delivery of such Security to the Paying Agent prior to, on or after the Purchase Date (together with all necessary endorsements) at the offices of the

27

Paying Agent, such delivery being a condition to receipt by the Holder of the Purchase Price therefor; provided, however, that such Purchase Price shall be so paid pursuant to this Section 3.08 only

if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof in the related Purchase Notice, as determined by the Company.

If a Holder, in such Holder's Purchase Notice and in any written notice of withdrawal delivered by such Holder pursuant to the terms of Section 3.10, fails to indicate such Holder's choice with respect to the election set forth in clause (D) of Section 3.08(a)(1), such Holder shall be deemed to have elected to receive cash in respect of the Purchase Price for all Securities subject to such Purchase Notice in the circumstances set forth in such clause (D).

The Company shall purchase from the Holder thereof, pursuant to this Section 3.08, a portion of a Security if the Original Principal Amount of such portion is \$1,000 or an integral multiple of \$1,000. Provisions of this Indenture that apply to the purchase of all of a Security also apply to the purchase of such portion of such Security.

Any purchase by the Company contemplated pursuant to the provisions of this Section 3.08 shall be consummated by the delivery of the consideration to be received by the Holder (together with accrued and unpaid cash interest, if any) promptly following the later of the Purchase Date and the time of delivery of the Security.

Notwithstanding anything herein to the contrary, any Holder delivering to the Paying Agent the Purchase Notice contemplated by this Section 3.08(a) shall have the right to withdraw such Purchase Notice at any time prior to the close of business on the business day prior to the Purchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 3.10.

The Paying Agent shall promptly notify the Company of the receipt by it of any Purchase Notice or written notice of withdrawal thereof.

(b) Company's Right to Elect Manner of Payment of Purchase Price. The Securities to be purchased pursuant to Section 3.08(a) may be paid for, at the election of the Company, in U.S. legal tender ("cash") or Common Stock, or in any combination of cash and Common Stock, subject to the conditions set forth in Sections 3.08(c) and (d). The Company shall designate, in the Company Notice delivered pursuant to Section 3.08(e), whether the Company will purchase the Securities for cash or Common Stock, or, if a combination thereof, the percentages or amounts of the Purchase Price of Securities in respect of which it will pay in cash or Common Stock; provided that the Company will pay cash for fractional interests in Common Stock. For purposes of determining the existence of potential fractional interests, all Securities subject to purchase by the Company held by a Holder shall be considered together (no matter how many separate certificates are to be presented). Each Holder whose Securities are purchased pursuant to this Section 3.08 shall receive the same percentage of cash or Common Stock in payment of the Purchase Price for such Securities, except (i) as provided in Section 3.08(d) with regard to the payment of cash in lieu of fractional shares of Common Stock and (ii) in the event that the Company is unable to purchase the Securities of a Holder or Holders for Common Stock because any necessary qualifications or registrations of the Common Stock

28

under applicable state securities laws cannot be obtained, the Company may purchase the Securities of such Holder or Holders for cash. The Company may not change its election with respect to the consideration (or components or percentages of components thereof) to be paid once the Company has given its Company Notice to Securityholders except pursuant to this Section 3.08(b) or pursuant to Section 3.08(d) in the event of a failure to satisfy, prior to the close of business on the Purchase Date, any condition to the payment of the Purchase Price, in whole or in part, in Common Stock.

At least three Business Days before the Company Notice Date, the Company shall deliver an Officers' Certificate to the Trustee specifying:

- (i) the manner of payment selected by the Company,
- (ii) the information required by Section 3.08(e),
- (iii) if the Company elects to pay the Purchase Price, or a

specified percentage thereof, in Common Stock, that the conditions to such manner of payment set forth in Section 3.08(d) have been or will be complied with, and

(iv) whether the Company desires the Trustee to give the Company Notice required by Section 3.08(e).

(c) Purchase with Cash. On each Purchase Date, at the option of the Company, the Purchase Price of Securities in respect of which a Purchase Notice pursuant to Section 3.08(a) has been given, or a specified percentage thereof, may be paid by the Company with cash equal to the aggregate Purchase Price of such Securities. If the Company elects to purchase Securities with cash, the Company Notice, as provided in Section 3.08(e), shall be sent to Holders (and to beneficial owners as required by applicable law) not less than 20 Business Days prior to such Purchase Date (the "Company Notice Date").

(d) Payment by Issuance of Common Stock. On each Purchase Date, at the option of the Company, the Purchase Price of Securities in respect of which a Purchase Notice pursuant to Section 3.08(a) has been given, or a specified percentage thereof, may be paid by the Company by the issuance of a number of shares of Common Stock equal to the quotient obtained by dividing (i) the amount of cash to which the Securityholders would have been entitled had the Company elected to pay all or such specified percentage, as the case may be, of the Purchase Price of such Securities in cash by (ii) the Market Price of a share of Common Stock, subject to the next succeeding paragraph.

The Company will not issue a fractional share of Common Stock in payment of the Purchase Price. Instead the Company will pay cash for the current market value of the fractional share. The current market value of a fraction of a share shall be determined by multiplying the Market Price by such fraction and rounding the product to the nearest whole cent. It is understood that if a Holder elects to have more than one Security purchased, the number of shares of Common Stock shall be based on the aggregate amount of Securities to be purchased.

29

If the Company elects to purchase the Securities by the issuance of shares of Common Stock, the Company Notice, as provided in Section 3.08(e), shall be sent to the Holders (and to beneficial owners as required by applicable law) not later than the Company Notice Date.

The Company's right to exercise its election to purchase the Securities pursuant to this Section 3.08 through the issuance of shares of Common Stock shall be conditioned upon:

(i) the Company's not having given its Company Notice of an election to pay entirely in cash and its giving of timely Company Notice of election to purchase all or a specified percentage of the Securities with Common Stock as provided herein;

(ii) the shares of Common Stock having been admitted for listing or admitted for listing subject to notice of issuance on the principal United States securities exchange on which the Common Stock is then listed or, if the Common Stock is not then listed on a national or regional securities exchange, as quoted on the National Association of Securities Dealers Automated Quotation System;

(iii) the registration of the shares of Common Stock to be issued in respect of the payment of the Purchase Price under the Securities Act of 1933, as amended (the "Securities Act"), or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in each case, if required;

(iv) any necessary qualification or registration under applicable state securities laws or the availability of an exemption from such qualification and registration; and

(v) the receipt by the Trustee of an Officers' Certificate and an Opinion of Counsel each stating that (A) the terms of the issuance of the Common Stock are in conformity with this Indenture and (B) the shares of Common Stock to be issued by the Company in payment of the Purchase Price in respect of Securities have been duly

authorized and, when issued and delivered pursuant to the terms of this Indenture in payment of the Purchase Price in respect of the Securities, will be validly issued, fully paid and non-assessable and, to the best of such counsel's knowledge, free from preemptive rights under applicable state law or known material contracts, and, in the case of such Officers' Certificate, stating that conditions (i), (ii), (iii) and (iv) above and the condition set forth in the second succeeding sentence have been satisfied and, in the case of such Opinion of Counsel, stating that conditions (ii) and (iii) above have been satisfied.

Such Officers' Certificate shall also set forth the number of shares of Common Stock to be issued for each \$1,000 Original Principal Amount of Securities and the Sale Price of a share of Common Stock on each trading day during the period for which the Market Price is calculated. The Company may pay the Purchase Price (or any portion thereof) in Common Stock only if the information necessary to calculate the Market Price is published in a daily newspaper of national circulation. If the foregoing conditions are not satisfied with respect to a Holder or Holders prior to the close of business on the Purchase Date and the Company has elected to

30

purchase the Securities pursuant to this Section 3.08 through the issuance of shares of Common Stock, the Company shall pay the entire Purchase Price of the Securities of such Holder or Holders in cash.

The "Market Price" of the Common Stock means the average of the Sale Prices of the Common Stock for the five trading day period ending on the third Business Day (if the third Business Day prior to the applicable Purchase Date is a trading day or, if not, then on the last trading day) prior to the applicable Purchase Date, appropriately adjusted to take into account the occurrence, during the period commencing on the first of such trading days during such five trading day period and ending on such Purchase Date, of any event described in Section 11.06, 11.07 or 11.08; subject, however, to the conditions set forth in Sections 11.09 and 11.10.

(e) Notice of Election. The Company's notice of election to purchase with cash or Common Stock or any combination thereof shall be sent to the Holders (and to beneficial owners as required by applicable law) in the manner provided in Section 14.02 at the time specified in Section 3.08(c) or (d), as applicable (the "Company Notice"). Such Company Notice shall state the manner of payment elected and shall contain the following information:

In the event the Company has elected to pay the Purchase Price (or a specified percentage thereof) with Common Stock, the Company Notice shall:

(1) state that each Holder will receive Common Stock with a Market Price determined as of a specified date prior to the Purchase Date equal to such specified percentage of the Purchase Price of the Securities held by such Holder (except any cash amount to be paid in lieu of fractional shares);

(2) set forth the method of calculating the Market Price of the Common Stock; and

(3) state that because the Market Price of Common Stock will be determined prior to the Purchase Date, Holders will bear the market risk with respect to the value of the Common Stock to be received from the date such Market Price is determined to the Purchase Date.

In any case, each Company Notice shall include a form of Purchase Notice to be completed by a Securityholder and shall state:

(i) the Purchase Price, the Conversion Rate and accrued and unpaid cash interest, if any, that will be accrued and payable with respect to the Securities as of the Purchase Date;

(ii) whether the Company will pay the Purchase Price in cash or in Common Stock or any combination thereof, specifying the percentage of each;

(iii) the name and address of the Paying Agent and the Conversion

Agent;

31

(iv) that Securities as to which a Purchase Notice has been given may be converted pursuant to Article 11 hereof only if the applicable Purchase Notice has been withdrawn in accordance with the terms of this Indenture;

(v) that Securities must be surrendered to the Paying Agent to collect payment of the Purchase Price and interest, if any;

(vi) that the Purchase Price for any Security as to which a Purchase Notice has been given and not withdrawn, together with any cash interest payable with respect thereto, will be paid promptly following the later of the Purchase Date and the time of surrender of such Security as described in (v);

(vii) the procedures the Holder must follow to exercise rights under Section 3.08 and a brief description of those rights;

(viii) briefly, the conversion rights of the Securities and that Holders who want to convert Securities must satisfy the requirements set forth in paragraph 9 of the Securities;

(ix) the procedures for withdrawing a Purchase Notice (including, without limitation, for a conditional withdrawal pursuant to the terms of Section 3.08(a)(1)(D) or Section 3.10);

(x) that, unless the Company defaults in making payment of such Purchase Price and cash interest, if any, the Variable Principal Amount will cease to increase and cash interest, if any, on Securities surrendered for purchase will cease to accrue on and after the Purchase Date; and

(xi) the CUSIP number of the Securities.

At the Company's request, the Trustee shall give such Company Notice in the Company's name and at the Company's expense; provided, however, that, in all cases, the text of such Company Notice shall be prepared by the Company.

Upon determination of the actual number of shares of Common Stock to be issued for each \$1,000 Original Principal Amount of Securities, the Company will issue a press release and publish such determination on the Company's web site on the World Wide Web.

(f) Covenants of the Company. All shares of Common Stock delivered upon purchase of the Securities shall be newly issued shares or treasury shares, shall be duly authorized, validly issued, fully paid and nonassessable and shall be free from preemptive rights and free of any lien or adverse claim created by the Company.

The Company shall use its reasonable efforts to list or cause to have quoted any shares of Common Stock to be issued to purchase Securities on the principal United States securities exchange or over-the-counter or other domestic market on which any other shares of the Common Stock are then listed or quoted. The Company will promptly inform the Trustee in writing of any such listing.

32

(g) Procedure upon Purchase. The Company shall deposit cash (in respect of a cash purchase under Section 3.08(c) or for fractional interests as applicable) or shares of Common Stock, or a combination thereof, as applicable, at the time and in the manner as provided in Section 3.11, sufficient to pay the aggregate Purchase Price of, and any accrued and unpaid interest with respect to all Securities to be purchased pursuant to this Section 3.08. As soon as practicable after the Purchase Date, the Company shall deliver to each Holder entitled to receive Common Stock through the Paying Agent, a certificate for the number of full shares of Common Stock issuable in payment of the Purchase Price and cash in lieu of any fractional interests. The person in whose name the

certificate for Common Stock is registered shall be treated as a holder of record of shares of Common Stock on the Business Day following the Purchase Date. Subject to Section 3.08(d), no payment or adjustment will be made for dividends on the Common Stock the record date for which occurred on or prior to the Purchase Date.

(h) Taxes. If a Holder of a Security is paid in Common Stock, the Company shall pay any documentary, stamp or similar issue or transfer tax due on such issue of shares of Common Stock. However, the Holder shall pay any such tax which is due because the Holder requests the shares of Common Stock to be issued in a name other than the Holder's name. The Paying Agent may refuse to deliver the certificates representing the Common Stock being issued in a name other than the Holder's name until the Paying Agent receives a sum sufficient to pay any tax which will be due because the shares of Common Stock are to be issued in a name other than the Holder's name. Nothing herein shall preclude any income tax withholding required by law or regulations.

SECTION 3.09 Purchase of Securities at Option of the Holder upon Change in Control.

(a) If there shall have occurred a Change in Control, Securities shall be purchased by the Company, at the option of the Holder thereof, at a purchase price specified in paragraph 7 of the Securities (the "Change in Control Purchase Price"), as of the date that is no later than 30 Business Days after the occurrence of the Change in Control but in no event prior to the date on which such Change in Control occurs (the "Change in Control Purchase Date"), subject to satisfaction by or on behalf of the Holder of the requirements set forth in Section 3.09(c).

A "Change in Control" means the occurrence of any of the following: (a) the sale, lease, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of the assets of the Company and its subsidiaries, taken as a whole, to any "person" or "group" (as such terms are used in Section 13(d) of the Exchange Act), (b) the adoption of a plan relating to the liquidation or dissolution of the Company, (c) the consummation of any transaction (including, without limitation, any merger or consolidation) the result of which is that any "person" or "group" (as such terms are used in Section 13(d) of the Exchange Act) becomes the "beneficial owner" (as such term is defined in Rule 13d-3 and Rule 13d-5 under the Exchange Act), directly or indirectly through one or more intermediaries, of more than 50% of the voting power of the outstanding voting stock of the Company, or (d) the first day on which more than a majority of the members of the Board of Directors of the Company are not Continuing Directors.

33

A "Continuing Director" means, as of any date of determination, any member of the Board of Directors of the Company who (a) was a member of the Board of Directors of the Company on March 21, 2003 or (b) was nominated for election to the Board of Directors of the Company with the approval of, or whose election to the Board of Directors of the Company was ratified by, at least a majority of the Continuing Directors who were members of the Board of Directors of the Company at the time of such nomination or election.

(b) Within 15 Business Days after the occurrence of a Change in Control, the Company shall mail a written notice of Change in Control by first-class mail to the Trustee and to each Holder (and to beneficial owners as required by applicable law). The notice shall include a form of Change in Control Purchase Notice to be completed by the Securityholder and shall state:

- (1) briefly, the events causing a Change in Control and the date of such Change in Control;
- (2) the date by which the Change in Control Purchase Notice pursuant to this Section 3.09 must be given;
- (3) the Change in Control Purchase Date;
- (4) the Change in Control Purchase Price and, to the extent known at the time of such notice, the amount of interest, if any, that will be accrued and payable with respect to the Securities as of the Change in Control Purchase Date;

(5) the name and address of the Paying Agent and the Conversion Agent;

(6) the Conversion Rate and any adjustments thereto resulting from the Change in Control;

(7) that Securities as to which a Change in Control Purchase Notice has been given may be converted pursuant to Article 11 hereof only if the Change in Control Purchase Notice has been withdrawn in accordance with the terms of this Indenture;

(8) that Securities must be surrendered to the Paying Agent to collect payment of the Change in Control Purchase Price and accrued and unpaid cash interest, if any;

(9) that the Change in Control Purchase Price for any Security as to which a Change in Control Purchase Notice has been duly given and not withdrawn, together with any accrued interest payable with respect thereto, will be paid promptly following the later of the Change in Control Purchase Date and the time of surrender of such Security as described in (8);

(10) briefly, the procedures the Holder must follow to exercise rights under this Section 3.09;

34

(11) briefly, the conversion rights of the Securities;

(12) the procedures for withdrawing a Change in Control Purchase Notice;

(13) that, unless the Company defaults in making payment of such Change in Control Purchase Price and cash interest, if any on Securities surrendered for purchase, the Variable Principal Amount will cease to increase and cash interest, if any, will cease to accrue on and after the Change in Control Purchase Date; and

(14) the CUSIP number of the Securities.

(c) A Holder may exercise its rights specified in Section 3.09(a) upon delivery of a written notice of purchase (a "Change in Control Purchase Notice") to the Paying Agent at any time prior to the close of business on the Change in Control Purchase Date, stating:

(1) the certificate number of the Security which the Holder will deliver to be purchased;

(2) the portion of the Original Principal Amount of the Security which the Holder will deliver to be purchased, which portion must be \$1,000 or an integral multiple thereof; and

(3) that such Security shall be purchased pursuant to the terms and conditions specified in paragraph 7 of the Securities.

The delivery of such Security to the Paying Agent prior to, on or after the Change in Control Purchase Date (together with all necessary endorsements) at the offices of the Paying Agent shall be a condition to the receipt by the Holder of the Change in Control Purchase Price therefor; provided, however, that such Change in Control Purchase Price shall be so paid pursuant to this Section 3.09 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof set forth in the related Change in Control Purchase Notice.

The Company shall purchase from the Holder thereof, pursuant to this Section 3.09, a portion of a Security if the Original Principal Amount of such portion is \$1,000 or an integral multiple of \$1,000. Provisions of this Indenture that apply to the purchase of all of a Security also apply to the purchase of such portion of such Security.

Any purchase by the Company contemplated pursuant to the provisions of this Section 3.09 shall be consummated by the delivery of the consideration

to be received by the Holder (together with accrued and unpaid interest, if any) promptly following the later of the Change in Control Purchase Date and the time of delivery of the Security to the Paying Agent in accordance with this Section 3.09.

Notwithstanding anything herein to the contrary, any Holder delivering to the Paying Agent the Change in Control Purchase Notice contemplated by this Section 3.09(c) shall have the right to withdraw such Change in Control Purchase Notice at any time prior to the close

35

of business on the Change in Control Purchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 3.10.

The Paying Agent shall promptly notify the Company of the receipt by it of any Change in Control Purchase Notice or written withdrawal thereof.

The Company shall not be required to comply with this Section 3.09 if a third party mails a written notice of Change in Control in the manner, at the times and otherwise in compliance with this Section 3.09 and repurchases all Securities for which a Change in Control Purchase Notice shall be delivered and not withdrawn.

SECTION 3.10 Effect of Purchase Notice or Change in Control Purchase Notice. Upon receipt by the Paying Agent of the Purchase Notice or Change in Control Purchase Notice specified in Section 3.08(a) or Section 3.09(c), as applicable, the Holder of the Security in respect of which such Purchase Notice or Change in Control Purchase Notice, as the case may be, was given shall (unless such Purchase Notice or Change in Control Purchase Notice is withdrawn as specified in the following two paragraphs) thereafter be entitled to receive solely the Purchase Price or Change in Control Purchase Price, as the case may be, and any accrued and unpaid interest, with respect to such Security. Such Purchase Price or Change in Control Purchase Price and any accrued and unpaid cash interest, if any, shall be paid to such Holder, subject to receipt of funds and/or securities by the Paying Agent, promptly following the later of (x) the Purchase Date or the Change in Control Purchase Date, as the case may be, with respect to such Security (provided the conditions in Section 3.08(a) or Section 3.09(c), as applicable, have been satisfied) and (y) the time of delivery of such Security to the Paying Agent by the Holder thereof in the manner required by Section 3.08(a) or Section 3.09(c), as applicable. Securities in respect of which a Purchase Notice or Change in Control Purchase Notice, as the case may be, has been given by the Holder thereof may not be converted pursuant to Article 11 hereof on or after the date of the delivery of such Purchase Notice or Change in Control Purchase Notice, as the case may be, unless such Purchase Notice or Change in Control Purchase Notice, as the case may be, has first been validly withdrawn as specified in the following two paragraphs.

A Purchase Notice or Change in Control Purchase Notice, as the case may be, may be withdrawn by means of a written notice of withdrawal delivered to the office of the Paying Agent in accordance with the Purchase Notice or Change in Control Purchase Notice, as the case may be, at any time prior to the close of business on the Purchase Date or the Change in Control Purchase Date, as the case may be, specifying:

- (1) the certificate number of the Security in respect of which such notice of withdrawal is being submitted,
- (2) the Original Principal Amount of the Security with respect to which such notice of withdrawal is being submitted, and
- (3) the Original Principal Amount, if any, of such Security which remains subject to the original Purchase Notice or Change in Control Purchase Notice, as

36

the case may be, and which has been or will be delivered for purchase by the Company.

A written notice of withdrawal of a Purchase Notice may be in the

form set forth in the preceding paragraph or may be in the form of (i) a conditional withdrawal contained in a Purchase Notice pursuant to the terms of Section 3.08(a)(1)(D) or (ii) a conditional withdrawal containing the information set forth in Section 3.08(a)(1)(D) and the preceding paragraph and contained in a written notice of withdrawal delivered to the Paying Agent as set forth in the preceding paragraph.

There shall be no purchase of any Securities pursuant to Section 3.08 (other than through the issuance of Common Stock in payment of the Purchase Price, including cash in lieu of fractional shares) or 3.09 if there has occurred (prior to, on or after, as the case may be, the giving, by the Holders of such Securities, of the required Purchase Notice or Change in Control Purchase Notice, as the case may be) and is continuing an Event of Default (other than a default in the payment of the Purchase Price or Change in Control Purchase Price, as the case may be, and any accrued and unpaid cash interest with respect to such Securities). The Paying Agent will promptly return to the respective Holders thereof any Securities (x) with respect to which a Purchase Notice or Change in Control Purchase Notice, as the case may be, has been withdrawn in compliance with this Indenture, or (y) held by it during the continuance of an Event of Default (other than a default in the payment of the Purchase Price or Change in Control Purchase Price, as the case may be, and any accrued and unpaid cash interest with respect to such Securities) in which case, upon such return, the Purchase Notice or Change in Control Purchase Notice with respect thereto shall be deemed to have been withdrawn.

SECTION 3.11 Deposit of Purchase Price or Change in Control Purchase Price. Prior to 10:00 a.m., New York City time, on the Business Day following the Purchase Date or the Change in Control Purchase Date, as the case may be, the Company shall deposit with the Trustee or with the Paying Agent (or, if the Company or a Subsidiary or an Affiliate of either of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.04) an amount of money (in immediately available funds if deposited on such Business Day) or Common Stock, if permitted hereunder, sufficient to pay the aggregate Purchase Price or Change in Control Purchase Price, as the case may be, of, and any accrued and unpaid cash interest with respect to, all the Securities or portions thereof which are to be purchased as of the Purchase Date or Change in Control Purchase Date, as the case may be. After the Purchase Date or the Change in Control Purchase Date, the Variable Principal Amount shall cease to increase, and cash interest, if any, shall cease to accrue on such Security, whether or not such Security is delivered to the Paying Agent.

SECTION 3.12 Securities Purchased in Part. Any Security which is to be purchased only in part shall be surrendered at the office of the Paying Agent (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or such Holder's attorney duly authorized in writing) and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without service charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate

Original Principal Amount equal to, and in exchange for, the portion of the Original Principal Amount of the Security so surrendered which is not purchased.

SECTION 3.13 Repayment to the Company. The Trustee and the Paying Agent shall promptly return to the Company any cash or shares of Common Stock that remain unclaimed as provided in paragraph 15 of the Securities, together with interest or dividends, if any, thereon (subject to the provisions of Section 7.01(f)), held by them for the payment of the Purchase Price or Change in Control Purchase Price, as the case may be, or cash interest, if any; provided, however, that to the extent that the aggregate amount of cash or shares of Common Stock deposited by the Company pursuant to Section 3.11 exceeds the aggregate Purchase Price or Change in Control Purchase Price, as the case may be, of, and the accrued and unpaid cash interest with respect to, the Securities or portions thereof which the Company is obligated to purchase as of the Purchase Date or Change in Control Purchase Date, as the case may be, whether as a result of withdrawal or otherwise, then promptly after the Business Day following the Purchase Date or Change in Control Purchase Date, as the case may be, the Trustee shall return any such excess to the Company together with interest or dividends, if any, thereon (subject to the provisions of Section 7.01(f)).

ARTICLE 4

COVENANTS

SECTION 4.01 Payment of Securities. The Company shall promptly make all payments in respect of the Securities on the dates and in the manner provided in the Securities or pursuant to this Indenture. Any amounts to be given to the Trustee or Paying Agent shall be deposited with the Trustee or Paying Agent by 10:00 a.m., New York City time, by the Company. Original Principal Amount, Restated Principal Amount, Variable Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price, and cash interest, if any, shall be considered paid on the applicable date due if on such date (or, in the case of a Purchase Price or Change in Control Purchase Price, on the Business Day following the applicable Purchase Date or Change in Control Purchase Date, as the case may be) the Trustee or the Paying Agent holds, in accordance with this Indenture, money or securities, if permitted hereunder, sufficient to pay all such amounts then due.

The Company shall, to the extent permitted by law, pay cash interest on overdue amounts at the rate per annum set forth in paragraph 1 of the Securities, compounded quarterly, which interest shall accrue from the date such overdue amount was originally due to the date payment of such amount, including interest thereon, has been made or duly provided for. All such interest shall be payable on demand. The accrual of such interest on overdue amounts shall be in lieu of, and not in addition to, the continued accrual of cash interest.

SECTION 4.02 SEC and Other Reports. If requested by the Trustee, the Company shall deliver to the Trustee, within 15 days after it files such annual and quarterly reports, information, documents and other reports with the SEC, copies of its annual and quarterly reports and of the information, documents and other reports (or copies of such portions of any of the foregoing as the SEC may by rules and regulations prescribe) which the Company is required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act. The

38

Company also shall comply with the provisions of TIA Section 314(a). Delivery of such reports, information and documents to the Trustee is for informational purposes only and the Trustee's receipt of the same shall not constitute constructive notice of any information contained therein or determinable from information contained therein, including the Company's compliance with any of its covenants hereunder (as to which the Trustee is entitled to rely exclusively on Officers' Certificates).

SECTION 4.03 Compliance Certificate. The Company shall deliver to the Trustee within 120 days after the end of each fiscal year of the Company (beginning with the fiscal year ending on December 31, 2003) an Officers' Certificate, stating whether or not to the best knowledge of the signers thereof the Company is in default in the performance and observance of any of the terms, provisions and conditions of this Indenture (without regard to any period of grace or requirement of notice provided hereunder) and if the Company shall be in default, specifying all such defaults and the nature and status thereof of which they may have knowledge.

SECTION 4.04 Further Instruments and Acts. Upon request of the Trustee, the Company will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of this Indenture.

SECTION 4.05 Maintenance of Office or Agency. The Company will maintain in the Borough of Manhattan, The City of New York, an office or agency of the Trustee, Registrar, Paying Agent and Conversion Agent where Securities may be presented or surrendered for payment, where Securities may be surrendered for registration of transfer, exchange, purchase, redemption or conversion and where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served. The office of U.S. Bank National Association, located at 100 Wall Street, 19th Floor, New York, New York (Attention: Corporate Trust Services), shall initially be such office or agency for all of the aforesaid purposes. The Company shall give prompt written notice to the Trustee of the location, and of any change in the location, of any such office or agency (other than a change in the location of the office of the Trustee). If at any time the Company shall fail to maintain any such required office or agency or

shall fail to furnish the Trustee with the address thereof, such presentations, surrenders, notices and demands may be made or served at the address of the Trustee set forth in Section 14.02.

The Company may also from time to time designate one or more other offices or agencies where the Securities may be presented or surrendered for any or all such purposes and may from time to time rescind such designations; provided, however, that no such designation or rescission shall in any manner relieve the Company of its obligation to maintain an office or agency in the Borough of Manhattan, The City of New York, for such purposes.

SECTION 4.06 Delivery of Certain Information. At any time when the Company is not subject to Section 13 or 15(d) of the Exchange Act, upon the request of a Holder or any beneficial holder of Securities or shares of Common Stock which are restricted securities issued upon conversion thereof, the Company will promptly furnish or cause to be furnished Rule 144A Information (as defined below) to such Holder or any beneficial holder of Securities or holder of shares of Common Stock issued upon conversion of Securities, or to a prospective purchaser of any such security designated by any such holder, as the case may be, to the extent

39

required to permit compliance by such Holder or holder with Rule 144A under the Securities Act in connection with the resale of any such security. "Rule 144A Information" shall be such information as is specified pursuant to Rule 144A(d) (4) under the Securities Act.

SECTION 4.07 Limitation on Guarantees of Indebtedness by Subsidiaries. The Company will not permit any Subsidiary, directly or indirectly, to guarantee the payment of any Debt of the Company unless such Subsidiary simultaneously executes and delivers a supplemental indenture providing for a guarantee of the Company's obligations under the Indenture and the Securities by such Subsidiary, which guarantee shall be senior to or equal with such Subsidiary's guarantee of such other Debt.

SECTION 4.08 Covenant to Comply With Securities Laws Upon Purchase of Securities. In connection with any offer to purchase or purchase of Securities under Section 3.08 or 3.09 hereof (provided that such offer or purchase constitutes an "issuer tender offer" for purposes of Rule 13e-4 (which term, as used herein, includes any successor provision thereto) under the Exchange Act at the time of such offer or purchase), the Company shall to the extent applicable (i) comply with Rule 13e-4 and Rule 14e-1 under the Exchange Act, (ii) file the related Schedule TO (or any successor schedule, form or report) under the Exchange Act, and (iii) otherwise comply with all Federal and state securities laws so as to permit the rights and obligations under Sections 3.08 and 3.09 to be exercised in the time and in the manner specified in Sections 3.08 and 3.09.

SECTION 4.09 Calculation of Certain Amounts. The Company shall file with the Trustee, within 30 days following the end of each calendar year, a written notice specifying (a) the amount of Tax Original Issue Discount (including the daily rates and accrual periods) accrued on outstanding Securities as of the end of such year and (b) such other specific information relating to such Tax Original Issue Discount as may then be relevant under the Internal Revenue Code of 1986, as amended from time to time.

ARTICLE 5

SUCCESSOR CORPORATION

SECTION 5.01 When Company May Merge or Transfer Assets. The Company shall not consolidate with or merge with or into any other person or convey, transfer or lease all or substantially all of its properties and assets to any person, nor will the Company permit any Subsidiary to enter into any such transaction or series of transactions if such transaction or series of transactions, in the aggregate, would result in a sale, assignment, transfer, lease or other disposition of all or substantially all of the properties and assets of the Company and its Subsidiaries on a consolidated basis to any other person or persons, unless:

(a) either (1) the Company or such subsidiary shall be the surviving corporation or (2) the person (if other than the Company) formed by such

consolidation or into which the Company or such Subsidiary is merged or the person which acquires by conveyance, transfer or lease the properties and assets of the Company or such Subsidiary substantially as an entirety (i) shall be organized and validly existing under the laws of the United States or any state thereof or the District of Columbia and (ii) shall expressly assume, by an indenture

40

supplemental hereto, executed and delivered to the Trustee, in form reasonably satisfactory to the Trustee, all of the obligations of the Company or such Subsidiary under the Securities and this Indenture;

(b) immediately after giving effect to such transaction, no Default shall have occurred and be continuing; and

(c) the Company shall have delivered to the Trustee an Officers' Certificate and an Opinion of Counsel, each stating that such consolidation, merger, conveyance, transfer or lease and, if a supplemental indenture is required in connection with such transaction, such supplemental indenture, comply with this Article 5 and that all conditions precedent herein provided for relating to such transaction have been satisfied.

For purposes of the foregoing, the transfer (by lease, assignment, sale or otherwise) of the properties and assets of one or more Subsidiaries (other than to the Company or another Subsidiary), which, if such assets were owned by the Company, would constitute all or substantially all of the properties and assets of the Company, shall be deemed to be the transfer of all or substantially all of the properties and assets of the Company.

The successor person formed by such consolidation or into which the Company or the applicable Subsidiary is merged or the successor person to which such conveyance, transfer or lease is made shall succeed to, and be substituted for, and may exercise every right and power of, the Company or the applicable Subsidiary under this Indenture with the same effect as if such successor had been named as the Company or the applicable Subsidiary herein; and thereafter, except in the case of a lease and any obligations the Company or the applicable Subsidiary may have under a supplemental indenture pursuant to Section 11.14, the Company or the applicable Subsidiary shall be discharged from all obligations and covenants under this Indenture and the Securities. Subject to Section 9.06, the Company, the applicable Subsidiary, the Trustee and the successor person shall enter into a supplemental indenture to evidence the succession and substitution of such successor person and such discharge and release of the Company and the applicable Subsidiary.

ARTICLE 6

DEFAULTS AND REMEDIES

SECTION 6.01 Events of Default. An "Event of Default" occurs if:

(1) the Company defaults in payment of any interest when due under the Securities and such default continues for 30 days, provided that a failure to make or provide for the payment in full of any of the first twelve scheduled cash interest payments on the Securities within three (3) Business Days of the applicable Interest Payment Date shall constitute an Event of Default with no additional grace or cure period if the proceeds from the Government Securities to be released from the Pledge Account prior to any such Interest Payment Date equal or exceed the cash interest payable on such Interest Payment Date;

41

(2) the Company defaults in the payment of the Original Principal Amount, the Variable Principal Amount (or, if the Securities have been converted to quarterly coupon notes following a Tax Event pursuant to Section 10.01 of the Indenture, the Restated Principal Amount), Redemption Price, Purchase Price or Change in Control Purchase Price on any Security when the same becomes due and payable;

(3) the Company fails to comply with any of its agreements in the Securities or this Indenture (other than those referred to in clauses (1) and (2) above) and such failure continues for 60 days after receipt by the Company of a Notice of Default;

(4) default under any Debt of the Company or any Subsidiary, whether such Debt now exists or is created later, which default results in such Debt becoming or being declared due and payable prior to the date on which it would otherwise have become due and payable, and the principal amount of all Debt so accelerated, together with all Debt due and payable but not paid prior to the end of any grace period, is \$35,000,000 or more, and such acceleration has not been rescinded or annulled within a period of 10 days after receipt by the Company of a Notice of Default from the Trustee; provided, however, that if any such default shall be cured, waived, rescinded or annulled, then the Event of Default by reason thereof shall be deemed not to have occurred;

(5) any guarantee that may be provided pursuant to Section 4.07 with respect to the Securities ceases to be in full force and effect or is declared null and void or any guarantor denies that it has any further liability under any guarantee, or gives notice to such effect (other than by reason of the termination of this Indenture or the release of any such guarantee in accordance with the applicable supplemental indenture) and such condition shall have continued for a period of 30 days after written notice of such failure requiring the guarantor and the Company to remedy the same shall have been given (x) to the Company by the Trustee or (y) to the Company and the Trustee by the holders of 25% in aggregate original principal amount of the Securities then outstanding

(6) the Company or any of its Significant Subsidiaries pursuant to or under or within the meaning of any Bankruptcy Law:

(A) commences a voluntary case or proceeding;

(B) consents to the entry of an order for relief against it in an involuntary case or proceeding or the commencement of any case against it;

(C) consents to the appointment of a Custodian of it or for any substantial part of its property;

(D) makes a general assignment for the benefit of its creditors;

42

(E) files a petition in bankruptcy or answer or consent seeking reorganization or relief; or

(F) consents to the filing of such petition or the appointment of or taking possession by a Custodian; or

(7) a court of competent jurisdiction enters an order or decree under any Bankruptcy Law that:

(A) is for relief against the Company or any of its Significant Subsidiaries in an involuntary case or proceeding, or adjudicates the Company or any of its subsidiaries insolvent or bankrupt;

(B) appoints a Custodian of the Company or any of its Significant Subsidiaries or for any substantial part of their respective property; or

(C) orders the winding up or liquidation of the Company or any of its Significant Subsidiaries;

and the order or decree remains unstayed and in effect for 60 days.

"Bankruptcy Law" means Title 11, United States Code, or any similar Federal or state law for the relief of debtors.

"Custodian" means any receiver, trustee, assignee, liquidator, custodian or similar official under any Bankruptcy Law.

A Default under clause (3) or clause (4) above is not an Event of Default until the Trustee notifies the Company, or the Holders of at least 25% in aggregate Original Principal Amount of the Securities at the time outstanding notify the Company and the Trustee, of the Default and the Company does not cure such Default (and such Default is not waived) within the time specified in clause (3) or clause (4) above after actual receipt of such notice. Any such notice must specify the Default, demand that it be remedied and state that such notice is a "Notice of Default".

The Company shall deliver to the Trustee, within 30 days after it becomes aware of the occurrence thereof, written notice of any event which with the giving of notice or the lapse of time, or both, would become an Event of Default under clause (3) or clause (4) above, its status and what action the Company is taking or proposes to take with respect thereto.

SECTION 6.02 Acceleration. If an Event of Default (other than an Event of Default specified in Section 6.01(6) or (7) in respect of the Company) occurs and is continuing, the Trustee by written Notice to the Company, or the Holders of at least 25% in aggregate Original Principal Amount of the Securities at the time outstanding by notice to the Company and the Trustee, may declare the Variable Principal Amount through the date of such declaration, and any accrued and unpaid cash interest (or if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued interest) through the date of declaration on all the Securities to be immediately due and payable. Upon

43

such a declaration, such Variable Principal Amount, and such accrued and unpaid interest, if any, shall be due and payable immediately. If an Event of Default specified in Section 6.01(6) or (7) occurs in respect of the Company and is continuing, the Variable Principal Amount, and any accrued and unpaid interest (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued interest) on all the Securities shall become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Securityholders. The Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding, by notice to the Trustee (and without notice to any other Securityholder) may rescind an acceleration and its consequences if the rescission would not conflict with any judgment or decree and if all existing Events of Default have been cured or waived except nonpayment of the Variable Principal Amount and any accrued and unpaid interest (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued interest) that have become due solely as a result of acceleration and if all amounts due to the Trustee under Section 7.07 have been paid. No such rescission shall affect any subsequent Default or impair any right consequent thereto.

SECTION 6.03 Other Remedies. If an Event of Default occurs and is continuing, the Trustee may pursue any available remedy to collect the payment of the Variable Principal Amount on the Securities or to enforce the performance of any provision of the Securities or this Indenture.

The Trustee may maintain a proceeding even if the Trustee does not possess any of the Securities or does not produce any of the Securities in the proceeding. A delay or omission by the Trustee or any Securityholder in exercising any right or remedy accruing upon an Event of Default shall not impair the right or remedy or constitute a waiver of, or acquiescence in, the Event of Default. Except as set forth in Section 2.07 hereof, no remedy is exclusive of any other remedy. All available remedies are cumulative.

SECTION 6.04 Waiver of Past Defaults. Subject to Section 6.02, the Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding, by notice to the Trustee (and without notice to any other Securityholder), may waive an existing Default and its consequences except (1) an Event of Default described in Section 6.01(1) or (2), (2) a Default in respect of a provision that under Section 9.02 cannot be amended without the

consent of each Securityholder affected or (3) a Default which constitutes a failure to convert any Security in accordance with the terms of Article 11. When a Default is waived, it is deemed cured, but no such waiver shall extend to any subsequent or other Default or impair any consequent right. This Section 6.04 shall be in lieu of Section 316(a)1(B) of the TIA and such Section 316(a)1(B) is hereby expressly excluded from this Indenture, as permitted by the TIA.

SECTION 6.05 Control by Majority. The Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or of exercising any trust or power conferred on the Trustee. However, the Trustee may refuse to follow any direction that conflicts with law or this Indenture or that the Trustee determines in good faith is unduly prejudicial to the rights of other Securityholders or would involve the Trustee in personal liability unless the Trustee is offered indemnity satisfactory to it. This Section 6.05 shall be in

44

lieu of Section 316(a)1(A) of the TIA and such Section 316(a)1(A) is hereby expressly excluded from this Indenture, as permitted by the TIA.

SECTION 6.06 Limitation on Suits. A Securityholder may not pursue any remedy with respect to this Indenture or the Securities unless:

- (1) the Holder gives to the Trustee written notice stating that an Event of Default is continuing;
- (2) the Holders of at least 25% in aggregate Original Principal Amount of the Securities at the time outstanding make a written request to the Trustee to pursue the remedy;
- (3) such Holder or Holders offer to the Trustee security or indemnity satisfactory to the Trustee against any loss, liability or expense;
- (4) the Trustee does not comply with the request within 60 days after receipt of such notice, request and offer of security or indemnity; and
- (5) the Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding do not give the Trustee a direction inconsistent with the request during such 60-day period.

A Securityholder may not use this Indenture to prejudice the rights of any other Securityholder or to obtain a preference or priority over any other Securityholder.

SECTION 6.07 Rights of Holders to Receive Payment. Notwithstanding any other provision of this Indenture, the right of any Holder to receive payment of the Original Principal Amount, the Variable Principal Amount (or if the Securities have been converted to quarterly coupon notes following a Tax Event pursuant to Article 10, the Restated Principal Amount, plus accrued cash interest), Redemption Price, Purchase Price, Change in Control Purchase Price, or cash interest in respect of the Securities held by such Holder, on or after the respective due dates expressed in the Securities or any Redemption Date, and to convert the Securities in accordance with Article 11, or to bring suit for the enforcement of any such payment on or after such respective dates or the right to convert, shall not be impaired or affected adversely without the consent of such Holder.

SECTION 6.08 Collection Suit by Trustee. If an Event of Default described in Section 6.01(1) or (2) occurs and is continuing, the Trustee may recover judgment in its own name and as trustee of an express trust against the Company for the whole amount owing with respect to the Securities and the amounts provided for in Section 7.07.

SECTION 6.09 Trustee May File Proofs of Claim. In case of the pendency of any receivership, insolvency, liquidation, bankruptcy, reorganization, arrangement, adjustment, composition or other judicial proceeding relative to the Company or any other obligor upon the Securities or the property of the Company or of such other obligor or their creditors, the Trustee (irrespective of whether the Original Principal Amount, the Variable

Principal Amount, Restated Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price or cash

45

interest in respect of the Securities shall then be due and payable as therein expressed or by declaration or otherwise and irrespective of whether the Trustee shall have made any demand on the Company for the payment of any such amount) shall be entitled and empowered, by intervention in such proceeding or otherwise,

(a) to file and prove a claim for the whole amount of the Original Principal Amount, the Variable Principal Amount, Restated Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price or cash interest in respect of the Securities (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued interest), as the case may be, and to file such other papers or documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel or any other amounts due the Trustee under Section 7.07) and of the Holders allowed in such judicial proceeding, and

(b) to collect and receive any moneys or other property payable or deliverable on any such claims and to distribute the same;

and any custodian, receiver, assignee, trustee, liquidator, sequestrator or similar official in any such judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly to the Holders, to pay the Trustee any amount due it for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, and any other amounts due the Trustee under Section 7.07.

Nothing herein contained shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Holder any plan of reorganization, arrangement, adjustment or composition affecting the Securities or the rights of any Holder thereof, or to authorize the Trustee to vote in respect of the claim of any Holder in any such proceeding.

SECTION 6.10 Priorities. If the Trustee collects any money pursuant to this Article 6, it shall pay out the money in the following order:

FIRST: to the Trustee for amounts due under Section 7.07;

SECOND: to Securityholders for amounts due and unpaid on the Securities for the Original Principal Amount, the Variable Principal Amount, Restated Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price or cash interest (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued cash interest), as the case may be, ratably, without preference or priority of any kind, according to such amounts due and payable on the Securities; and

THIRD: the balance, if any, to the Company.

The Trustee may fix a record date and payment date for any payment to Securityholders pursuant to this Section 6.10. At least 15 days before such record date, the

46

Trustee shall mail to each Securityholder and the Company a notice that states the record date, the payment date and the amount to be paid.

SECTION 6.11 Undertaking for Costs. In any suit for the enforcement of any right or remedy under this Indenture or in any suit against the Trustee for any action taken or omitted by it as Trustee, a court in its discretion may require the filing by any party litigant (other than the Trustee) in the suit of an undertaking to pay the costs of the suit, and the court in its discretion may

assess reasonable costs, including reasonable attorneys' fees and expenses, against any party litigant in the suit, having due regard to the merits and good faith of the claims or defenses made by the party litigant. This Section 6.11 does not apply to a suit by the Trustee, a suit by a Holder pursuant to Section 6.07 or a suit by Holders of more than 10% in aggregate Original Principal Amount of the Securities at the time outstanding. This Section 6.11 shall be in lieu of Section 315(e) of the TIA and such Section 315(e) is hereby expressly excluded from this Indenture, as permitted by the TIA.

SECTION 6.12 Waiver of Stay, Extension or Usury Laws. The Company covenants (to the extent that it may lawfully do so) that it will not at any time insist upon, or plead, or in any manner whatsoever claim or take the benefit or advantage of, any stay or extension law or any usury or other law wherever enacted, now or at any time hereafter in force, which would prohibit or forgive the Company from paying all or any portion of the Original Principal Amount, the Variable Principal Amount, Restated Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price or cash interest (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount, plus accrued interest), as contemplated herein, or which may affect the covenants or the performance of this Indenture; and the Company (to the extent that it may lawfully do so) hereby expressly waives all benefit or advantage of any such law, and covenants that it will not hinder, delay or impede the execution of any power herein granted to the Trustee, but will suffer and permit the execution of every such power as though no such law had been enacted.

ARTICLE 7

TRUSTEE

SECTION 7.01 Duties of Trustee.

(a) If an Event of Default has occurred and is continuing, the Trustee shall exercise the rights and powers vested in it by this Indenture and use the same degree of care and skill in its exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

(b) Except during the continuance of an Event of Default:

(1) the Trustee need perform only those duties that are specifically set forth in this Indenture and no others; and

(2) in the absence of bad faith on its part, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed

47

therein, upon certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture, but in case of any such certificates or opinions which by any provision hereof are specifically required to be furnished to the Trustee, the Trustee shall examine the certificates and opinions to determine whether or not they conform to the requirements of this Indenture, but need not confirm or investigate the accuracy of mathematical calculations or other facts stated therein.

This Section 7.01(b) shall be in lieu of Section 315(a) of the TIA and such Section 315(a) is hereby expressly excluded from this Indenture, as permitted by the TIA.

(c) The Trustee may not be relieved from liability for its own negligent action, its own negligent failure to act or its own willful misconduct, except that:

(1) this paragraph (c) does not limit the effect of paragraph (b) of this Section 7.01;

(2) the Trustee shall not be liable for any error of judgment made in good faith by a Responsible Officer unless it is proved that the Trustee was negligent in ascertaining the pertinent facts; and

(3) the Trustee shall not be liable with respect to any action it takes or omits to take in good faith in accordance with a direction received by it pursuant to Section 6.05.

Subparagraphs (c)(1), (2) and (3) shall be in lieu of Sections 315(d)(1), 315(d)(2) and 315(d)(3) of the TIA and such Sections 315(d)(1), 315(d)(2) and 315(d)(3) are hereby expressly excluded from this Indenture, as permitted by the TIA.

(d) Every provision of this Indenture that in any way relates to the Trustee is subject to paragraphs (a), (b), (c) and (e) of this Section 7.01.

(e) The Trustee may refuse to perform any duty or exercise any right or power or extend or risk its own funds or otherwise incur any financial liability unless it receives indemnity satisfactory to it against any loss, liability or expense.

(f) Money held by the Trustee in trust hereunder need not be segregated from other funds except to the extent required by law. The Trustee (acting in any capacity hereunder) shall be under no liability for interest on any money received by it hereunder unless otherwise agreed in writing with the Company.

SECTION 7.02 Rights of Trustee. Subject to its duties and responsibilities under the provisions of Section 7.01, and, except as expressly excluded from this Indenture pursuant to said Section 7.01, subject also to its duties and responsibilities under the TIA:

(a) the Trustee may conclusively rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness

48

or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;

(b) whenever in the administration of this Indenture the Trustee shall deem it desirable that a matter be proved or established prior to taking, suffering or omitting any action hereunder, the Trustee (unless other evidence be herein specifically prescribed) may, in the absence of bad faith on its part, conclusively rely upon an Officers' Certificate;

(c) the Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and the Trustee shall not be responsible for any misconduct or negligence on the part of any agent or attorney appointed with due care by it hereunder;

(d) the Trustee shall not be liable for any action taken, suffered, or omitted to be taken by it in good faith which it believes to be authorized or within its rights or powers conferred under this Indenture;

(e) the Trustee may consult with counsel selected by it and any advice or Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken or suffered or omitted by it hereunder in good faith and in accordance with such advice or Opinion of Counsel;

(f) the Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request, order or direction of any of the Holders, pursuant to the provisions of this Indenture, unless such Holders shall have offered to the Trustee security or indemnity satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby;

(g) any request or direction of the Company mentioned herein shall be sufficiently evidenced by a Company Request or Company Order and any resolution of the Board of Directors may be sufficiently evidenced by a resolution of the Board of Directors;

(h) the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement,

instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the Trustee shall determine to make such further inquiry or investigation, it shall be entitled to examine the books, records and premises of the Company, personally or by agent or attorney at the sole cost of the Company and shall incur no liability or additional liability of any kind by reason of such inquiry or investigation;

(i) the Trustee shall not be deemed to have notice of any Default or Event of Default unless a Responsible Officer of the Trustee has actual knowledge thereof or unless written notice of any event which is in fact such a default is received by a Responsible Officer of the Trustee at the Corporate Trust Office of the Trustee, and such notice references the Securities and this Indenture;

49

(j) the rights, privileges, protections, immunities and benefits given to the Trustee, including, without limitation, its right to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder, and to each agent, custodian and other Person employed to act hereunder; and

(k) the Trustee may request that the Company deliver an Officers' Certificate setting forth the names of individuals and/or titles of officers authorized at such time to take specified actions pursuant to this Indenture, which Officers' Certificate may be signed by any person authorized to sign an Officers' Certificate, including any person specified as so authorized in any such certificate previously delivered and not superseded.

SECTION 7.03 Individual Rights of Trustee. The Trustee in its individual or any other capacity may become the owner or pledgee of Securities and may otherwise deal with the Company or its Affiliates with the same rights it would have if it were not Trustee. Any Paying Agent, Registrar, Conversion Agent or co-registrar may do the same with like rights. However, the Trustee must comply with Sections 7.10 and 7.11.

SECTION 7.04 Trustee's Disclaimer. The Trustee makes no representation as to the validity or adequacy of this Indenture, the Securities or the Pledged Securities, it shall not be accountable for the Company's use or application of the proceeds from the Securities, it shall not be responsible for any statement in the registration statement for the Securities under the Securities Act or in the Indenture or the Securities (other than its certificate of authentication), or the determination as to which beneficial owners are entitled to receive any notices hereunder.

SECTION 7.05 Notice of Defaults. If a Default occurs and if it is known to a Responsible Officer of the Trustee, the Trustee shall give to each Securityholder notice of the Default within 90 days after such Responsible Officer obtains knowledge of such Default unless such Default shall have been cured or waived before the giving of such notice. Except in the case of a Default described in Section 6.01(1) or (2), the Trustee may withhold the notice if and so long as a committee of its Responsible Officers in good faith determines that withholding the notice is in the interests of Securityholders. The second sentence of this Section 7.05 shall be in lieu of the proviso to Section 315(b) of the TIA and such proviso is hereby expressly excluded from this Indenture, as permitted by the TIA. The Trustee shall not be deemed to have knowledge of a Default unless a Responsible Officer of the Trustee has received written notice of such Default.

SECTION 7.06 Reports by Trustee to Holders. Within 60 days after each April 15 beginning with the April 15 following the date of this Indenture, the Trustee shall mail to each Securityholder a brief report dated as of such April 15 that complies with TIA Section 313(a), if required by such Section 313(a). The Trustee also shall comply with TIA Section 313(b).

A copy of each report at the time of its mailing to Securityholders shall be filed with the SEC and each securities exchange, if any, on which the Securities are listed. The Company agrees to promptly notify the Trustee whenever the Securities become listed on any securities exchange and of any delisting thereof.

(a) to pay to the Trustee from time to time such reasonable compensation as the Company and the Trustee shall from time to time agree in writing for all services rendered by it hereunder (which compensation shall not be limited (to the extent permitted by law) by any provision of law in regard to the compensation of a trustee of an express trust);

(b) to reimburse the Trustee upon its request for all reasonable expenses, disbursements and advances incurred or made by the Trustee in accordance with any provision of this Indenture (including the reasonable compensation and the expenses, advances and disbursements of its agents and counsel), except any such expense, disbursement or advance as may be attributable to its negligence or bad faith; and

(c) to indemnify the Trustee or any predecessor Trustee and their agents for, and to hold them harmless against, any loss, damage, claim, liability, cost or expense (including reasonable attorney's fees and expenses and taxes (other than taxes based upon, measured by or determined by the income of the Trustee)) incurred without negligence or bad faith on its part, arising out of or in connection with the acceptance or administration of this trust, including the reasonable costs and expenses of defending itself against any claim (whether asserted by the Company or any Holder or any other Person) or liability in connection with the exercise or performance of any of its powers or duties hereunder.

To secure the Company's payment obligations in this Section 7.07, the Holders shall have been deemed to have granted to the Trustee a lien prior to the Securities on all money or property held or collected by the Trustee, except that held in trust to pay the Variable Principal Amount, Redemption Price, Purchase Price, Change in Control Purchase Price, or cash interest, if any, as the case may be, on particular Securities.

The Company's payment obligations pursuant to this Section 7.07 shall survive the discharge of this Indenture and the resignation or removal of the Trustee. When the Trustee incurs expenses after the occurrence of a Default specified in Section 6.01(6) or (7), the expenses including the reasonable charges and expenses of its counsel, are intended to constitute expenses of administration under any Bankruptcy Law.

SECTION 7.08 Replacement of Trustee. The Trustee may resign by so notifying the Company; provided, however, no such resignation shall be effective until a successor Trustee has accepted its appointment pursuant to this Section 7.08. The Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding may remove the Trustee by so notifying the Trustee and the Company. The Company shall remove the Trustee if:

- (1) the Trustee fails to comply with Section 7.10;
- (2) the Trustee is adjudged bankrupt or insolvent;
- (3) a receiver or public officer takes charge of the Trustee or its property; or

- (4) the Trustee otherwise becomes incapable of acting.

If the Trustee resigns or is removed or if a vacancy exists in the office of the Trustee for any reason, the Company shall promptly appoint, by resolution of its Board of Directors, a successor Trustee.

A successor Trustee shall deliver a written acceptance of its appointment to the retiring Trustee and to the Company satisfactory in form and substance to the retiring Trustee and the Company. Thereupon the resignation or removal of the retiring Trustee shall become effective, and the successor Trustee shall have all the rights, powers and duties of the Trustee under this

Indenture. The successor Trustee shall mail a notice of its succession to Securityholders. The retiring Trustee shall promptly transfer all property held by it as Trustee to the successor Trustee, subject to the lien provided for in Section 7.07.

If a successor Trustee does not take office within 30 days after the retiring Trustee resigns or is removed, the retiring Trustee, the Company or the Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding may petition any court of competent jurisdiction at the expense of the Company for the appointment of a successor Trustee.

If the Trustee fails to comply with Section 7.10, any Securityholder may petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor Trustee.

SECTION 7.09 Successor Trustee by Merger. If the Trustee consolidates with, merges or converts into, or transfers all or substantially all its corporate trust business or assets to, another corporation, the resulting, surviving or transferee corporation without any further act shall be the successor Trustee.

SECTION 7.10 Eligibility; Disqualification. The Trustee shall at all times satisfy the requirements of TIA Sections 310(a)(1) and 310(b). The Trustee (or its parent holding company) shall have a combined capital and surplus of at least \$50,000,000 as set forth in its most recent published annual report of condition. Nothing herein contained shall prevent the Trustee from filing with the Commission the application referred to in the penultimate paragraph of TIA Section 310(b).

SECTION 7.11 Preferential Collection of Claims Against Company. The Trustee shall comply with TIA Section 311(a), excluding any creditor relationship listed in TIA Section 311(b). A Trustee who has resigned or been removed shall be subject to TIA Section 311(a) to the extent indicated therein.

ARTICLE 8

DISCHARGE OF INDENTURE

SECTION 8.01 Discharge of Liability on Securities. When (i) the Company delivers to the Trustee all outstanding Securities (other than Securities replaced pursuant to Section 2.07) for cancellation or (ii) all outstanding Securities have become due and payable and

52

the Company irrevocably deposits with the Trustee, the Paying Agent (if the Paying Agent is not the Company or any of its Affiliates) or the Conversion Agent cash or, if expressly permitted by the terms of the Securities or the Indenture, Common Stock sufficient to pay all amounts due and owing on all outstanding Securities (other than Securities replaced pursuant to Section 2.07), and if in either case the Company pays all other sums payable hereunder by the Company, then this Indenture shall, subject to Section 7.07, cease to be of further effect. The Trustee shall join in the execution of a document prepared by the Company acknowledging satisfaction and discharge of this Indenture on demand of the Company accompanied by an Officers' Certificate and Opinion of Counsel and at the cost and expense of the Company.

SECTION 8.02 Repayment to the Company. The Trustee and the Paying Agent shall return to the Company upon written request any money or securities held by them for the payment of any amount with respect to the Securities that remains unclaimed for two years, subject to applicable unclaimed property law. After return to the Company, Holders entitled to the money or securities must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person and the Trustee and the Paying Agent shall have no further liability to the Securityholders with respect to such money or securities for that period commencing after the return thereof.

ARTICLE 9

AMENDMENTS

SECTION 9.01 Without Consent of Holders. The Company and the Trustee may amend this Indenture or the Securities without the consent of any

Securityholder:

- (1) to cure any ambiguity, omission, defect or inconsistency;
- (2) to comply with Article 5 or Section 11.14;
- (3) in exchange for Securityholders agreeing to waive their right to require the Company to purchase all or a portion of their Securities on a specified Purchase Date, to add additional Purchase Dates on which Securityholders may require the Company to purchase all or a portion of their Securities at the applicable Purchase Price and, in addition, to pay such Securityholders additional cash payments in connection therewith;
- (4) to secure the Company's obligations under the Securities and this Indenture;
- (5) to add to the Company's covenants for the benefit of the Securityholders or to surrender any right or power conferred upon the Company;
- (6) to make any change to comply with the TIA, or any amendment thereto, or to comply with any requirement of the SEC in connection with the qualification of the Indenture under the TIA, or as necessary in connection with the registration of the Securities under the Securities Act; or

53

- (7) to make any change that does not adversely affect the rights of any Holders (it being understood that any amendment described in clause (1) above made solely to conform this Indenture to the final offering memorandum provided to investors in connection with the initial offering of the Securities will be deemed not to adversely affect the rights or interests of Holders).

SECTION 9.02 With Consent of Holders. With the written consent of the Holders of at least a majority in aggregate Original Principal Amount of the Securities at the time outstanding, the Company and the Trustee may amend this Indenture or the Securities. However, without the consent of each Securityholder affected, an amendment to this Indenture or the Securities may not:

- (1) reduce the percentage in Original Principal Amount of Securities whose Holders must consent to an amendment;
- (2) make any change in the manner or rate of accrual of Variable Principal Amount or cash interest, reduce the rate of cash interest referred to in paragraph 1 of the Securities, or extend the time for payment of Variable Principal Amount or cash interest on any Security;
- (3) reduce the Original Principal Amount, Variable Principal Amount or Restated Principal Amount or cash interest, with respect to any Security, or extend the Stated Maturity of any Security;
- (4) reduce the Redemption Price, Purchase Price or Change in Control Purchase Price of any Security;
- (5) make any Security payable in money or securities other than that stated in the Security;
- (6) make any change in Article 10 of the Indenture, or this Section 9.02, except to increase any percentage set forth therein;
- (7) make any change that adversely affects the right to convert any Security;
- (8) make any change that adversely affects the right to require the Company to purchase the Securities in accordance with the terms thereof and this Indenture; or
- (9) impair the right to institute suit for the enforcement of any payment with respect to, or conversion of, the Securities.

It shall not be necessary for the consent of the Holders under this Section 9.02 to approve the particular form of any proposed amendment, but it shall be sufficient if such consent approves the substance thereof.

After an amendment under this Section 9.02 becomes effective, the Company shall mail to each Holder a notice briefly describing the amendment.

54

SECTION 9.03 Compliance with Trust Indenture Act. Every supplemental indenture executed pursuant to this Article shall comply with the TIA.

SECTION 9.04 Revocation and Effect of Consents, Waivers and Actions. Until an amendment, consent, waiver or other action by Holders becomes effective, a consent thereto by a Holder of a Security hereunder is a continuing consent by the Holder and every subsequent Holder of that Security or portion of the Security that evidences the same obligation as the consenting Holder's Security, even if notation of the amendment, consent, waiver or other action is not made on the Security. However, any such Holder or subsequent Holder may revoke the consent as to such Holder's Security or portion of the Security if the Trustee receives the notice of revocation before the date as of which the amendment, consent, waiver or action is made effective. After an amendment, consent, waiver or action becomes effective, it shall bind every Securityholder.

SECTION 9.05 Notation on or Exchange of Securities. Securities authenticated and delivered after the execution of any supplemental indenture pursuant to this Article may, and shall if required by the Trustee, bear a notation in form approved by the Trustee as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities so modified as to conform, in the opinion of the Board of Directors, to any such supplemental indenture may be prepared and executed by the Company and authenticated and delivered by the Trustee in exchange for outstanding Securities.

SECTION 9.06 Trustee to Sign Supplemental Indentures. The Trustee shall sign any supplemental indenture authorized pursuant to this Article 9 if the amendment contained therein does not adversely affect the rights, duties, liabilities or immunities of the Trustee. If it does, the Trustee may, but need not, sign such supplemental indenture. In signing such supplemental indenture the Trustee shall receive, and (subject to the provisions of Section 7.01) shall be fully protected in relying upon, in addition to the documents required by Section 14.04, an Officers' Certificate and an Opinion of Counsel stating that such amendment is authorized or permitted by this Indenture.

SECTION 9.07 Effect of Supplemental Indentures. Upon the execution of any supplemental indenture under this Article, this Indenture shall be modified in accordance therewith, and such supplemental indenture shall form a part of this Indenture for all purposes; and every Holder of Securities theretofore or thereafter authenticated and delivered hereunder shall be bound thereby.

ARTICLE 10

SPECIAL TAX EVENT CONVERSION

SECTION 10.01 Optional Conversion to Quarterly Coupon Note upon Tax Event. From and after the date (the "Tax Event Date") of the occurrence of a Tax Event after March 21, 2008, the Company shall have the option to elect, in lieu of having Variable Principal Amount increase, to have interest accrue and be paid in cash at the Variable Yield per annum, on a Restated Principal Amount, per \$1,000 Original Principal Amount (the "Restated Principal Amount") equal to the accrued Variable Principal Amount through the Tax Event Date or the

55

date the Company exercises the option provided for in this Section 10.01, whichever is later (the "Option Exercise Date"). Such interest shall be payable quarterly on March 21, June 21, September 21 and December 21 of each year to Holders of record at the close of business on March 7, June 7, September 7 and December 7 immediately preceding such interest payment date. Interest will

accrue from the most recent date on which interest has been paid or, if no interest has been paid, from the Option Exercise Date. Within 15 days of the occurrence of a Tax Event, the Company shall deliver a written notice of such Tax Event by facsimile and first-class mail to the Trustee and within 15 days of its exercise of such option the Company shall deliver a written notice of the Option Exercise Date by facsimile and first-class mail to the Trustee and by first class mail to the Holders of the Securities. From and after the Option Exercise Date, (i) the Company shall be obligated to pay at Stated Maturity, in lieu of the Variable Principal Amount of a Security, the Restated Principal Amount thereof plus accrued and unpaid interest on such Security and (ii) "Variable Principal Amount" or similar words, as used herein, shall mean Restated Principal Amount plus accrued and unpaid interest with respect to any Security. Securities authenticated and delivered after the Option Exercise Date may, and shall if required by the Trustee, bear a notation in a form approved by the Trustee as to the conversion of the Securities to quarterly coupon notes. No other changes to this Indenture shall result as a result of the events described in this Section 10.01.

ARTICLE 11

CONVERSION

SECTION 11.01 Conversion Privilege. A Holder of a Security may convert such Security into shares of Common Stock at any time during the periods and subject to the conditions stated in paragraph 9 of the Securities, subject to the provisions of this Article 11. The number of shares of Common Stock issuable upon conversion of a Security per \$1,000 of Original Principal Amount thereof (the "Conversion Rate") shall be determined in accordance with the provisions of paragraph 9 of the Securities. The initial number of shares of Common Stock issuable upon conversion of a Security per \$1,000 of Original Principal Amount thereof shall equal 38.4615, subject to adjustment.

A Holder may convert a portion of the Original Principal Amount of a Security if the portion is \$1,000 or an integral multiple of \$1,000. Provisions of this Indenture that apply to conversion of all of a Security also apply to conversion of a portion of a Security.

SECTION 11.02 Conversion Procedure. To convert a Security, a Holder must satisfy the requirements in paragraph 9 of the Securities. The date on which the Holder satisfies all those requirements is the conversion date (the "Conversion Date"). Following the Conversion Date, the Company shall deliver to the Holder through the Conversion Agent, in accordance with Section 11.20 a certificate for the number of full shares of Common Stock issuable upon the conversion and cash in lieu of any fractional share determined pursuant to Section 11.03. The Company shall determine such full number of shares and the amounts of the required cash with respect to any fractional share, and shall set forth such information in an Officers' Certificate delivered to the Conversion Agent. The Conversion Agent shall have no duties under this paragraph unless and until it has received such certificate.

56

The Person in whose name the certificate is registered shall be treated as a stockholder of record on and after the Conversion Date; provided, however, that no surrender of a Security on any date when the stock transfer books of the Company shall be closed shall be effective to constitute the Person or Persons entitled to receive the shares of Common Stock upon such conversion as the record holder or holders of such shares of Common Stock on such date, but such surrender shall be effective to constitute the Person or Persons entitled to receive such shares of Common Stock as the record holder or holders thereof for all purposes at the close of business on the next succeeding day on which such stock transfer books are open; such conversion shall be at the Conversion Rate in effect on the date that such Security shall have been surrendered for conversion, as if the stock transfer books of the Company had not been closed. Upon conversion of a Security, such Person shall no longer be a Holder of such Security.

Holders may surrender a Security for conversion by means of book-entry delivery in accordance with paragraph 9 of the Security and the regulations of the applicable book-entry facility.

No payment or adjustment will be made for dividends on, or other distributions with respect to, any Common Stock except as provided in this

Article 11. On conversion of a Security, the increases in variable principal amount and accrued cash interest attributable to the period from the Issue Date of the Security through the Conversion Date, with respect to the converted Security shall not be cancelled, extinguished or forfeited, but rather shall be deemed to be paid in full to the Holder thereof through delivery of the Common Stock (together with the cash payment, if any, in lieu of fractional shares) in exchange for the Security being converted pursuant to the provisions hereof; and the fair market value of such shares of Common Stock (together with any such cash payment in lieu of fractional shares) shall be treated as issued, to the extent thereof, first in exchange for the increases in variable principal amount and accrued cash interest through the Conversion Date, and the balance, if any, of such fair market value of such Common Stock (and any such cash payment) shall be treated as issued in exchange for the Issue Price of the Security being converted pursuant to the provisions hereof. Notwithstanding the foregoing, accrued cash interest will be payable upon conversion of Securities made concurrently with or after acceleration of Securities following an Event of Default.

If the Holder converts more than one Security at the same time, the number of shares of Common Stock issuable upon conversion shall be based on the aggregate Original Principal Amount of the Securities converted.

A Security surrendered for conversion based on (a) the Common Stock price may be surrendered for conversion until the close of business on March 21, 2023, (b) the Security being called for redemption may be surrendered for conversion at any time prior to the close of business on the second Business Day immediately preceding the Redemption Date, even if it is not otherwise convertible at such time, and (c) upon the occurrence of certain corporate transactions more fully described in paragraph 9 of the Security may be surrendered for conversion at any time from and after the date which is 15 days prior to the anticipated effective date of such transaction until 15 days after the actual date of such transaction, and if such day is not a Business Day, the next occurring Business Day following such day.

57

Upon surrender of a Security that is converted in part, the Company shall execute, and the Trustee shall authenticate and deliver to the Holder, a new Security in an authorized denomination equal in Original Principal Amount to the unconverted portion of the Security surrendered.

SECTION 11.03 Fractional Shares. The Company will not issue a fractional share of Common Stock upon conversion of a Security. Instead, the Company will deliver cash for the current market value of the fractional share. The current market value of a fractional share shall be determined, to the nearest 1/1,000th of a share, by multiplying the per share Sale Price of the Common Stock, on the last Trading Day prior to the Conversion Date, by the fractional amount and rounding the product to the nearest whole cent.

SECTION 11.04 Taxes on Conversion. If a Holder converts a Security, the Company shall pay any documentary, stamp or similar issue or transfer tax due on the issue of shares of Common Stock upon the conversion. However, the Holder shall pay any such tax which is due because the Holder requests the shares to be issued in a name other than the Holder's name and any income tax which is imposed on the Holder as a result of the conversion. The Conversion Agent may refuse to deliver the certificates representing the Common Stock being issued in a name other than the Holder's name until the Conversion Agent receives a sum sufficient to pay any tax which will be due because the shares are to be issued in a name other than the Holder's name. Nothing herein shall preclude the Company from any tax withholding or directing the withholding of any tax required by law or regulations.

SECTION 11.05 Company to Provide Stock. The Company shall, prior to issuance of any Securities under this Article 11, and from time to time as may be necessary, reserve out of its authorized but unissued Common Stock a sufficient number of shares of Common Stock to permit the conversion of the Securities.

All shares of Common Stock delivered upon conversion of the Securities shall be newly issued shares or treasury shares, shall be duly and validly issued and fully paid and nonassessable and shall be free from preemptive rights and free of any lien or adverse claim created by the Company.

The Company will endeavor promptly to comply with all federal and state securities laws regulating the offer and delivery of shares of Common Stock upon conversion of Securities, if any, and will list or cause to have quoted such shares of Common Stock on each national securities exchange or in the over-the-counter market or such other market on which the Common Stock is then listed or quoted.

SECTION 11.06 Adjustment for Change in Capital Stock. Except as set forth in Section 11.14, if, after the Issue Date of the Securities, the Company:

(a) pays a dividend or makes a distribution on its Common Stock in shares of its Common Stock or other Capital Stock;

(b) subdivides its outstanding shares of Common Stock into a greater number of shares;

58

(c) pays a dividend or makes a distribution of its Common Stock in shares of its Capital Stock (other than Common Stock or rights, warrants or options for its Capital Stock);

(d) combines its outstanding shares of Common Stock into a smaller number of shares; or

(e) issues by reclassification of its Common Stock any shares of its Capital Stock (other than rights, warrants or options for its Capital Stock);

then the conversion privilege and the Conversion Rate in effect immediately prior to such action shall be adjusted so that the Holder of a Security thereafter converted may receive the number of shares or other units of Capital Stock of the Company which such Holder would have owned immediately following such action if such Holder had converted the Security immediately prior to such action.

The adjustment shall become effective immediately after the record date in the case of a dividend or distribution and immediately after the effective date in the case of a subdivision, combination or reclassification.

SECTION 11.07 Adjustment for Rights Issue. Except as set forth in Sections 11.14 and 11.19, if after the Issue Date, the Company distributes any rights, warrants or options to all holders of its Common Stock entitling them, for a period expiring within 60 days after the record date for such distribution, to purchase shares of Common Stock at a price per share less than the Sale Price of the Common Stock as of the Time of Determination, the Conversion Rate shall be adjusted in accordance with the formula:

$$R' = \frac{R (O + N)}{(O + [(N \times P)/M])}$$

where:

R' = the adjusted Conversion Rate.

R = the current Conversion Rate.

O = the number of shares of Common Stock outstanding on the record date for the distribution to which this Section 11.07 is being applied.

N = the number of additional shares of Common Stock offered pursuant to the distribution.

P = the offering price per share of the additional shares.

M = the Average Sale Price, minus, in the case of (i) a distribution to which Section 11.06(b) applies or (ii) a distribution to which Section 11.08 applies, for which, in each case, (x) the record date shall occur on or before the record date for the distribution to which this Section 11.07 applies and (y) the Ex-Dividend Time shall occur on or after the date of the Time of

Determination for the distribution to which this Section 11.07 applies, the fair market value (on the record date for the distribution to which this Section 11.07 applies) of:

- (i) the Capital Stock of the Company distributed in respect of each share of Common Stock in such Section 11.06(b) distribution; and
- (ii) the assets of the Company or debt securities or any rights, warrants or options to purchase securities of the Company distributed in respect of each share of Common Stock in such Section 11.08 distribution.

The Board of Directors shall determine fair market values for the purposes of this Section 11.07.

The adjustment shall become effective immediately after the record date for the determination of shareholders entitled to receive the rights, warrants or options to which this Section 11.07 applies. If all of the shares of Common Stock subject to such rights, warrants or options have not been issued when such rights, warrants or options expire, then the Conversion Rate shall promptly be readjusted to the Conversion Rate which would then be in effect had the adjustment upon the issuance of such rights, warrants or options been made on the basis of the actual number of shares of Common Stock issued upon the exercise of such rights, warrants or options.

No adjustment shall be made under this Section 11.07 if the application of the formula stated above in this Section 11.07 would result in a value of R' that is equal to or less than the value of R.

SECTION 11.08 Adjustment for Other Distributions. (a) Subject to Section 11.08(b), if, after the Issue Date of the Securities, the Company distributes to all holders of its Common Stock any of its assets excluding distributions of Capital Stock or equity interests referred to in Section 11.08(b), or evidence of indebtedness or any rights, warrants or options to purchase securities of the Company (including securities or cash, but excluding (x) distributions of Capital Stock referred to in Section 11.06 and distributions of rights, warrants or options referred to in Section 11.07 and (y) cash dividends or other cash distributions that are paid out of consolidated current net earnings or earnings retained in the business as shown on the books of the Company unless such cash dividends or other cash distributions are Extraordinary Cash Dividends), the Conversion Rate shall be adjusted, subject to the provisions of Section 11.08(c), in accordance with the formula:

$$R' = \frac{R \times M}{M - F}$$

where:

R' = the adjusted Conversion Rate.

R = the current Conversion Rate.

60

M = the Average Sale Price, minus, in the case of a distribution to which Section 11.06(c) applies, for which (i) the record date shall occur on or before the record date for the distribution to which this Section 11.08 applies and (ii) the Ex-Dividend Time shall occur on or after the date of the Time of Determination for the distribution to which this Section 11.08 applies, the fair market value (on the record date for the distribution to which this Section 11.08 applies) of any Capital Stock of the Company distributed in respect of each share of Common Stock in such Section 11.06(c) distribution.

F = the fair market value (on the record date for the distribution to which this Section 11.08 applies) of the assets, securities, rights, warrants or options to be distributed in respect of each share of Common Stock in the distribution to which this Section 11.08 is being applied (including, in the case of cash dividends or other cash distributions giving rise to an adjustment, all such cash distributed concurrently).

The Board of Directors shall determine fair market values for the purposes of this Section 11.08.

The adjustment shall become effective immediately after the record date for the determination of shareholders entitled to receive the distribution to which this Section 11.08 applies.

For purposes of this Section 11.08, the term "Extraordinary Cash Dividend" shall mean any cash dividend or distribution with respect to the Common Stock the amount of which, together with the aggregate amount of cash dividends on the Common Stock to be aggregated with such cash dividend in accordance with the provisions of this paragraph, equals or exceeds the threshold percentage set forth in item (i) below. For purposes of item (i) below, the "Ex-Dividend Measurement Period" with respect to a cash dividend on the Common Stock shall mean the 365 consecutive day period ending on the date prior to the Ex-Dividend Time with respect to such cash dividend, and the "Relevant Cash Dividends" with respect to a cash dividend on the Common Stock shall mean the cash dividends on the Common Stock with Ex-Dividend Times occurring in the Ex-Dividend Measurement Period.

(i) If, upon the date prior to the Ex-Dividend Time with respect to a cash dividend on the Common Stock, the aggregate amount of such cash dividend together with the amounts of all Relevant Cash Dividends equals or exceeds on a per share basis 5% of the Sale Price of the Common Stock on the last Trading Day preceding the date of declaration by the Board of Directors of the cash dividend or distribution with respect to which this provision is being applied, then such cash dividend together with all Relevant Cash Dividends, shall be deemed to be an Extraordinary Cash Dividend and for purposes of applying the formula set forth above in this Section 11.08, the value of "F" shall be equal to (y) the aggregate amount of such cash dividend together with the amount of all Relevant Cash Dividends, minus (z) the aggregate amount of all Relevant Cash Dividends for which a prior adjustment in the Conversion Rate was previously made under this Section 11.08.

61

In making the determinations required by item (i) above, the amount of cash dividends paid on a per share basis and the amount of any Relevant Cash Dividends specified in item (i) above, shall be appropriately adjusted to reflect the occurrence during such period of any event described in Section 11.06.

(b) If, after the Issue Date of the Securities, the Company pays a dividend or makes a distribution to all holders of its Common Stock consisting of Capital Stock of any class or series, or similar equity interests, of or relating to a Subsidiary or other business unit of the Company, the Conversion Rate shall be adjusted in accordance with the formula:

$$R' = R \times (1 + F/M)$$

where:

R' = the adjusted Conversion Rate.

R = the current Conversion Rate.

M = the average of the Sale Prices of the Common Stock for the ten (10) trading days commencing on and including the fifth trading day after the date on which "ex-dividend trading" commences for such dividend or distribution on The New York Stock Exchange or such other national or regional exchange or market which such securities are then listed or quoted (the "Ex-Dividend Date").

F = the fair market value of the securities distributed in respect of each share of Common Stock for which this Section 11.08(b) applies shall mean the number of securities distributed in respect of each share of Common Stock multiplied by the average of the Sale Prices of those securities distributed for the ten (10) trading days commencing on and including the fifth trading day after the Ex-Dividend Date.

(c) In the event that, with respect to any distribution to which Section 11.08(a) would otherwise apply, the difference between "M-F" as defined

in the formula set forth in Section 11.08(a) is less than \$1.00 or "F" is equal to or greater than "M", then the adjustment provided by Section 11.08(a) shall not be made and in lieu thereof the provisions of Section 11.14 shall apply to such distribution.

SECTION 11.09 When Adjustment May Be Deferred. No adjustment in the Conversion Rate need be made unless the adjustment would require an increase or decrease of at least 1% in the Conversion Rate. Any adjustments that are not made shall be carried forward and taken into account in any subsequent adjustment and all adjustments that are made and carried forward shall be taken in the aggregate in order to determine if the 1% threshold is met.

All calculations under this Article 11 shall be made to the nearest cent or to the nearest 1/1,000th of a share, as the case may be.

SECTION 11.10 When No Adjustment Required. No adjustment need be made for a transaction referred to in Section 11.06, 11.07, 11.08 or 11.14 if Securityholders are to participate in the transaction on a basis and with notice that the Board of Directors determines to

62

be fair and appropriate in light of the basis and notice on which holders of Common Stock participate in the transaction. Such participation by Securityholders may include participation upon conversion provided that an adjustment shall be made at such time as the Securityholders are no longer entitled to participate.

No adjustment need be made for rights to purchase Common Stock pursuant to a Company plan for reinvestment of dividends or interest.

No adjustment need be made for a change in the par value or no par value of the Common Stock.

To the extent the Securities become convertible pursuant to this Article 11 into cash, no adjustment need be made thereafter as to the cash. Interest will not accrue on the cash.

No adjustment will be made pursuant to this Article 11 that would result, through the application of two or more provisions hereof, in the duplication of any adjustment.

SECTION 11.11 Notice of Adjustment. Whenever the Conversion Rate is adjusted, the Company shall promptly mail to Securityholders a notice of the adjustment. The Company shall file with the Trustee and the Conversion Agent such notice and a certificate from the Company's independent public accountants briefly stating the facts requiring the adjustment and the manner of computing it. Upon receipt by it of such notice, and at the written request of the Company, the Conversion Agent will promptly mail such notice to Securityholders at the Company's expense. The certificate shall be conclusive evidence that the adjustment is correct. Neither the Trustee nor any Conversion Agent shall be under any duty or responsibility with respect to any such certificate except to exhibit the same to any Holder desiring inspection thereof.

SECTION 11.12 Voluntary Increase. The Company from time to time may increase the Conversion Rate by any amount for any period of time. Whenever the Conversion Rate is increased, the Company shall mail to Securityholders and file with the Trustee and the Conversion Agent a notice of the increase. The Company shall mail the notice at least 15 days before the date the increased Conversion Rate takes effect. The notice shall state the increased Conversion Rate and the period it will be in effect.

A voluntary increase of the Conversion Rate does not change or adjust the Conversion Rate otherwise in effect for purposes of Section 11.06, 11.07 or 11.08 or 11.14.

SECTION 11.13 Notice of Certain Transactions. If:

(a) the Company takes any action that would require an adjustment in the Conversion Rate pursuant to Section 11.06, 11.07 or 11.08 (unless no adjustment is to occur pursuant to Section 11.10); or

(b) the Company takes any action that would require a supplemental

indenture pursuant to Section 11.14; or

(c) there is a liquidation or dissolution of the Company;

63

then the Company shall mail to Securityholders and file with the Trustee and the Conversion Agent a notice stating the proposed record date for a dividend or distribution or the proposed effective date of a subdivision, combination, reclassification, consolidation, merger, binding share exchange, transfer, liquidation or dissolution. The Company shall file and mail the notice at least 15 days before such date. Failure to file or mail the notice or any defect in it shall not affect the validity of the transaction.

SECTION 11.14 Reorganization of Company; Special Distributions. If the Company is a party to a transaction subject to Article 5 (other than a sale of all or substantially all of the assets of the Company in a transaction in which the holders of Common Stock immediately prior to such transaction do not receive securities, cash, property or other assets of the Company or any other Person) or a merger or binding share exchange which reclassifies or changes its outstanding Common Stock, the Person obligated to deliver securities, cash or other assets upon conversion of Securities shall enter into a supplemental indenture. If the issuer of securities deliverable upon conversion of Securities is an Affiliate of the successor Company, that issuer shall join in the supplemental indenture.

The supplemental indenture shall provide that the Holder of a Security may convert it into the kind and amount of securities, cash or other assets which such Holder would have received immediately after the consolidation, merger, binding share exchange or transfer if such Holder had converted the Security immediately before the effective date of the transaction, assuming (to the extent applicable) that such Holder (i) was not a constituent Person or an Affiliate of a constituent Person to such transaction; (ii) made no election with respect thereto; and (iii) was treated alike with the plurality of non-electing Holders. The supplemental indenture shall provide for adjustments which shall be as nearly equivalent as may be practical to the adjustments provided for in this Article 11. The successor Company shall mail to Securityholders a notice briefly describing the supplemental indenture.

If this Section applies, neither Section 11.06 nor 11.07 applies.

If the Company makes a distribution to all holders of its Common Stock of any of its assets, or debt securities or any rights, warrants or options to purchase securities of the Company that would otherwise result in an adjustment in the Conversion Rate pursuant to the provisions of Section 11.08, then, from and after the record date for determining the holders of Common Stock entitled to receive the distribution, a Holder of a Security that converts such Security in accordance with the provisions of this Indenture shall upon such conversion be entitled to receive, in addition to the shares of Common Stock into which the Security is convertible, the kind and amount of securities, cash or other assets comprising the distribution that such Holder would have received if such Holder had converted the Security immediately prior to the record date for determining the holders of Common Stock entitled to receive the distribution.

SECTION 11.15 Company Determination Final. Any determination that the Company or the Board of Directors must make pursuant to Section 11.03, 11.06, 11.07, 11.08, 11.09, 11.10, 11.14 or 11.17 is conclusive.

64

SECTION 11.16 Trustee's Adjustment Disclaimer. The Trustee has no duty to determine when an adjustment under this Article 11 should be made, how it should be made or what it should be. The Trustee has no duty to determine whether a supplemental indenture under Section 11.14 need be entered into or whether any provisions of any supplemental indenture are correct. The Trustee shall not be accountable for and makes no representation as to the validity or value of any securities or assets issued upon conversion of Securities. The Trustee shall not be responsible for the Company's failure to comply with this Article 11. Each Conversion Agent (other than the Company or an Affiliate of the Company) shall have the same protection under this Section 11.16 as the Trustee.

SECTION 11.17 Simultaneous Adjustments. In the event that this Article 11 requires adjustments to the Conversion Rate under more than one of Sections 11.06, 11.07 or 11.08, and the record dates for the distributions giving rise to such adjustments shall occur on the same date, then such adjustments shall be made by applying, first, the provisions of Section 11.06, second, the provisions of Section 11.08 and, third, the provisions of Section 11.07.

SECTION 11.18 Successive Adjustments. After an adjustment to the Conversion Rate under this Article 11, any subsequent event requiring an adjustment under this Article 11 shall cause an adjustment to the Conversion Rate as so adjusted.

SECTION 11.19 Rights Issued in Respect of Common Stock Issued Upon Conversion. Each share of Common Stock issued upon conversion of Securities pursuant to this Article 11 shall be entitled to receive the appropriate number of common stock or preferred stock purchase rights, as the case may be (the "Rights"), if any, that all shares of Common Stock are entitled to receive and the certificates representing the Common Stock issued upon such conversion shall bear such legends, if any, in each case as may be provided by the terms of any shareholder rights agreement adopted by the Company, as the same may be amended from time to time (in each case, a "Rights Agreement"). Provided that such Rights Agreement requires that each share of Common Stock issued by the Company (including those that might be issued upon conversion of Securities) at any time prior to the distribution of separate certificates representing the Rights be entitled to receive such Rights, then, notwithstanding anything else to the contrary in this Article 11, there shall not be any adjustment to the conversion privilege or Conversion Rate or any other term or provision of the Securities as a result of the issuance of Rights, the distribution of separate certificates representing the Rights, the exercise or redemption of such Rights in accordance with any such Rights Agreement, or the termination or invalidation of such Rights.

SECTION 11.20 Company's Right to Elect to Pay Cash or Common Stock. In lieu of delivery of Common Stock upon notice of conversion of any Securities, the Company may elect to pay holders surrendering Securities an amount in cash per \$1,000 Original Principal Amount per Security equal to the Average Sale Price of Common Stock for the five consecutive trading days immediately following either (a) the date of notice of election to deliver cash as described below if the Company has not given notice of redemption, or (b) the conversion date, in the case of conversion following the notice of redemption specifying that the Company intends to deliver cash upon conversion, in either case multiplied by the Conversion Rate in effect on that date. The Company will inform the holders through the Trustee no later than two business days following the conversion date of its election to deliver shares of Common Stock or

65

to pay cash in lieu of delivery of Common Stock, unless the Company has already informed holders of its election in connection with its optional redemption of the Securities pursuant to Section 3.1 herein. If the Company elects to deliver all of such payment in Common Stock, the Common Stock will be delivered through the Conversion Agent no later than the fifth business day following the Conversion Date. If the Company elects to pay all or a portion of such payment in cash, the payment, including any delivery of Common Stock, will be made to holders surrendering Securities no later than the tenth business day following the applicable conversion date. If an Event of Default (other than a default in a cash payment upon conversion of the Securities) has occurred and is continuing, the Company may not pay cash upon conversion of any Security or portion of a Security (other than cash for fractional shares).

ARTICLE 12

PAYMENT OF INTEREST

SECTION 12.01 Interest Payments. Interest on any Security that is payable, and is punctually paid or duly provided for, on any applicable payment date shall be paid to the person in whose name that Security is registered at the close of business on the Regular Record Date or accrual date, as the case may be, for such interest at the office or agency of the Company maintained for such purpose. Each installment of quarterly interest on any Security shall be paid in same-day funds by transfer to an account maintained by the payee located

inside the United States, if the Trustee shall have received proper wire transfer instructions from such payee not later than the related Regular Record Date or accrual date, as the case may be, or, if no such instructions have been received, by check drawn on a bank in New York City mailed to the payee at its address set forth on the Registrar's books. In the case of a permanent Global Security, quarterly interest payable on any applicable payment date will be paid to the Depositary, with respect to that portion of such permanent Global Security held for its account by Cede & Co. for the purpose of permitting such party to credit the interest received by it in respect of such permanent Global Security to the accounts of the beneficial owners thereof.

SECTION 12.02 Defaulted Interest. Except as otherwise specified with respect to the Securities, any interest on any Security that is payable, but is not punctually paid or duly provided for, within 30 days following any applicable payment date (herein called "Defaulted Interest", which term shall include any accrued and unpaid interest that has accrued on such defaulted amount in accordance with paragraph 1 of the Securities), shall forthwith cease to be payable to the registered Holder thereof on the relevant Regular Record Date or accrual date, as the case may be, by virtue of having been such Holder, and such Defaulted Interest may be paid by the Company, at its election in each case, as provided in clause (1) or (2) below:

(1) The Company may elect to make payment of any Defaulted Interest to the persons in whose names the Securities are registered at the close of business on a special record date for the payment of such Defaulted Interest, which shall be fixed in the following manner. The Company shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each Security and the date of the proposed payment (which shall not be less than 20 days after such notice is received by the Trustee), and at the same time the Company shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to

66

be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit on or prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the persons entitled to such Defaulted Interest as in this clause provided. Thereupon the Trustee shall fix a special record date (the "Special Record Date") for the payment of such Defaulted Interest which shall be not more than 15 days and not less than 10 days prior to the date of the proposed payment and not less than 10 days after the receipt by the Trustee of the notice of the proposed payment. The Trustee shall promptly notify the Company of such Special Record Date and, in the name and at the expense of the Company, shall cause notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor to be mailed, first-class postage prepaid, to each Holder of Securities at his address as it appears on the list of Securityholders maintained pursuant to Section 2.05 not less than 10 days prior to such Special Record Date. Notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor having been mailed as aforesaid, such Defaulted Interest shall be paid to the persons in whose names the Securities are registered at the close of business on such Special Record Date and shall no longer be payable pursuant to the following clause (2).

(2) The Company may make payment of any Defaulted Interest on the Securities in any other lawful manner not inconsistent with the requirements of any securities exchange on which such Securities may be listed, and upon such notice as may be required by such exchange, if, after notice given by the Company to the Trustee of the proposed payment pursuant to this clause, such manner of payment shall be deemed practicable by the Trustee.

SECTION 12.03 Interest Rights Preserved. Subject to the foregoing provisions of this Article 12 and Section 2.06, each Security delivered under this Indenture upon registration of transfer of or in exchange for or in lieu of any other Security shall carry the rights to quarterly interest accrued and unpaid, and to accrue, which were carried by such other Security.

SECURITY

SECTION 13.01 Security.

(a) On the date of this Indenture, the Company shall (i) enter into the Pledge Agreement and comply with the terms and provisions thereof and (ii) purchase the Pledged Securities to be pledged to the Trustee for the benefit of the Holders in such amount as the Company expects shall be sufficient, upon receipt of scheduled interest and/or of principal payments of such Pledged Securities, to provide for payment in full of the first twelve scheduled interest payments (up to and including the interest payment due on March 21, 2006) due on the Securities. The Pledged Securities shall be pledged by the Company to the Trustee for the benefit of the Holders and shall be held by the Trustee in the Pledge Account pending disposition pursuant to the Pledge Agreement.

67

(b) Each Holder, by its acceptance of a Security, consents and agrees to the terms of the Pledge Agreement (including, without limitation, the provisions providing for foreclosure and release of the Pledged Securities) as the same may be in effect or may be amended from time to time in accordance with its terms, and authorizes and directs the Trustee to enter into the Pledge Agreement and to perform its respective obligations and exercise its respective rights thereunder in accordance therewith. The Company will do or cause to be done all such acts and things as may be necessary or reasonably requested by the Trustee, or as may be required by the provisions of the Pledge Agreement, to assure and confirm to the Trustee the security interest in the Pledged Securities contemplated hereby, by the Pledge Agreement or any part thereof, as from time to time constituted, so as to render the same available for the security and benefit of this Indenture and of the Securities secured hereby, according to the intent and purposes herein and therein expressed. The Company, in consultation with the Trustee, shall take, or shall cause to be taken, any and all actions reasonably required to cause the Pledge Agreement to create and maintain, as security for the obligations of the Company under this Indenture and the Securities, valid and enforceable first priority liens in and on all the Pledged Securities, in favor of the Trustee, superior to and prior to the rights of third Persons and subject to no other Liens.

(c) The release of any Pledged Securities pursuant to the Pledge Agreement will not be deemed to impair the security under this Indenture in contravention of the provisions hereof if and to the extent the Pledged Securities are released pursuant to this Indenture and the Pledge Agreement. To the extent applicable, the Company shall cause TIA Section 314(d) relating to the release of property or securities from the Lien and security interest of the Pledge Agreement and relating to the substitution therefor of any property or securities to be subjected to the Lien and security interest of the Pledge Agreement to be complied with. Any certificate or opinion required by TIA Section 314(d) may be made by an Officer of the Company, except in cases where TIA Section 314(d) requires that such certificate or opinion be made by an independent Person, which Person shall be an independent engineer, appraiser or other expert selected by the Company.

(d) The Company shall cause TIA Section 314(b), relating to opinions of counsel regarding the Lien under the Pledge Agreement, to be complied with. The Trustee may accept, to the extent permitted by Sections 4.03 and 7.06 as conclusive evidence of compliance with the foregoing provisions, the appropriate statements contained in such instruments.

(e) The Trustee may, in its sole discretion and without the consent of the Holders, on behalf of the Holders, take all reasonable actions in accordance with the Pledge Agreement necessary or appropriate in order to (i) enforce any of the terms of the Pledge Agreement and (ii) collect and receive any and all amounts payable in respect of the obligations of the Company thereunder. The Trustee shall have power to institute and to maintain such suits and proceedings as the Trustee may reasonably deem expedient to preserve or protect its interests and the interests of the Holders in the Pledged Securities (including power to institute and maintain suits or proceedings to restrain the enforcement of or compliance with any legislative or other governmental enactment, rule or order that may be unconstitutional or otherwise invalid if the enforcement of, or compliance with, such enactment, rule or order would impair the security interest hereunder or be prejudicial to the interests of the

Holders or of the Trustee).

68

ARTICLE 14

MISCELLANEOUS

SECTION 14.01 Trust Indenture Act Controls. If any provision of this Indenture limits, qualifies, or conflicts with another provision which is required to be included in this Indenture by the TIA, the required provision shall control.

SECTION 14.02 Notices. Any request, demand, authorization, notice, waiver, consent or communication shall be in writing and delivered in person or delivery by courier guaranteeing overnight delivery or mailed by first-class mail, postage prepaid, addressed as follows or transmitted by facsimile transmission (confirmed by guaranteed overnight courier) to the following facsimile numbers:

if to the Company:

Alaska Air Group, Inc.
19300 Pacific Highway South
Seattle, Washington 98188
Attention: Chief Financial Officer
Fax: (206) 431-5007

with a copy of any notice given pursuant to Article 6 to:

O'Melveny & Myers LLP
400 S. Hope Street
Los Angeles, California 90071
Attention: David Johnson, Esq.
Fax: (213) 430-6407

if to the Trustee:

U.S. Bank National Association
1 Federal Street, 3rd Floor
Boston, Massachusetts 02110
Attention: Corporate Trust Services
Fax: (617) 603-6667

The Company or the Trustee by notice given to the other in the manner provided above may designate additional or different addresses for subsequent notices or communications.

Any notice or communication given to a Securityholder shall be mailed to the Securityholder, by first-class mail, postage prepaid, at the Securityholder's address as it appears on the registration books of the Registrar and shall be sufficiently given if so mailed within the time prescribed.

Failure to mail a notice or communication to a Securityholder or any defect in it shall not affect its sufficiency with respect to other Securityholders. If a notice or

69

communication is mailed in the manner provided above, it is duly given, whether or not received by the addressee.

If the Company mails a notice or communication to the Securityholders, it shall mail a copy to the Trustee and each Registrar, Paying Agent, Conversion Agent or co-registrar.

SECTION 14.03 Communication by Holders with Other Holders. Securityholders may communicate pursuant to TIA Section 312(b) with other Securityholders with respect to their rights under this Indenture or the Securities. The Company, the Trustee, the Registrar, the Paying Agent, the

Conversion Agent and anyone else shall have the protection of TIA Section 312(c).

SECTION 14.04 Certificate and Opinion as to Conditions Precedent. Upon any request or application by the Company to the Trustee to take any action under this Indenture, the Company shall furnish to the Trustee if reasonably requested:

(1) an Officers' Certificate stating that, in the opinion of the signers, all conditions precedent, if any, provided for in this Indenture relating to the proposed action have been complied with; and

(2) an Opinion of Counsel stating that, in the opinion of such counsel, all such conditions precedent have been complied with.

SECTION 14.05 Statements Required in Certificate or Opinion. Each Officers' Certificate or Opinion of Counsel with respect to compliance with a covenant or condition provided for in this Indenture shall include to the extent required by the Trustee:

(1) a statement that each person making such Officers' Certificate or Opinion of Counsel has read such covenant or condition;

(2) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such Officers' Certificate or Opinion of Counsel are based;

(3) a statement that, in the opinion of each such person, he has made such examination or investigation as is necessary to enable such person to express an informed opinion as to whether or not such covenant or condition has been complied with; and

(4) a statement that, in the opinion of such person, such covenant or condition has been complied with.

SECTION 14.06 Separability Clause. In case any provision in this Indenture or in the Securities shall be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

SECTION 14.07 Rules by Trustee, Paying Agent, Conversion Agent and Registrar. The Trustee may make reasonable rules for action by or a meeting of Securityholders.

70

The Registrar, Conversion Agent and the Paying Agent may make reasonable rules for their functions.

SECTION 14.08 Calculations. The calculation of the Variable Interest Rate, Variable Principal Amount, Variable Yield, 3-month LIBOR, Purchase Price, Change in Control Purchase Price, Conversion Rate, Market Price, Sale Price of the Common Stock and each other calculation to be made hereunder shall be the obligation of the Calculation Agent. All calculations made by the Calculation Agent as contemplated pursuant to this Section 14.08 shall be final and binding on the Company and the Holders absent manifest error. The Company, Trustee, Paying Agent and Conversion Agent shall not be obligated to recalculate, recompute or confirm any such calculations. However, any calculations may be recalculated to correct errors at any time.

SECTION 14.09 Legal Holidays. A "Legal Holiday" is any day other than a Business Day. If any specified date (including a date for giving notice) is a Legal Holiday, the action shall be taken on the next succeeding day that is not a Legal Holiday, and, if the action to be taken on such date is a payment in respect of the Securities, no interest shall accrue for the intervening period.

SECTION 14.10 GOVERNING LAW. THE LAWS OF THE STATE OF NEW YORK SHALL GOVERN THIS INDENTURE AND THE SECURITIES.

SECTION 14.11 No Recourse Against Others. A director, officer, employee, agent, representative, stockholder or equity holder, as such, of the Company shall not have any liability for any obligations of the Company under

the Securities or this Indenture or for any claim based on, in respect of or by reason of such obligations or their creation. By accepting a Security, each Securityholder shall waive and release all such liability. The waiver and release shall be part of the consideration for the issue of the Securities.

SECTION 14.12 Successors. All agreements of the Company in this Indenture and the Securities shall bind its successor. All agreements of the Trustee in this Indenture shall bind its successor.

SECTION 14.13 Multiple Originals. The parties may sign any number of copies of this Indenture. Each signed copy shall be an original, but all of them together represent the same agreement. One originally signed copy is enough to prove this Indenture.

71

IN WITNESS WHEREOF, the undersigned, being duly authorized, have executed this Indenture on behalf of the respective parties hereto as of the date first above written.

ALASKA AIR GROUP, INC.

By: /s/ Bradley Tilden

Name: Bradley Tilden
Title: Executive Vice President/
Finance & Chief Financial
Officer

U.S. BANK NATIONAL ASSOCIATION

By: /s/ Julie A. Balerna

Name: Julie A. Balerna
Title: Assistant Vice President

EXHIBIT A-1

[FORM OF FACE OF GLOBAL SECURITY]

FOR PURPOSES OF SECTIONS 1272, 1273 AND 1275 OF THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED, THIS SECURITY IS ISSUED WITH AN INDETERMINATE AMOUNT OF ORIGINAL ISSUE DISCOUNT FOR UNITED STATES FEDERAL INCOME TAX PURPOSES. THE ISSUE DATE IS MARCH 21, 2003, AND THE YIELD TO MATURITY BASED ON A FIXED RATE EQUIVALENT FOR PURPOSES OF ACCRUING ORIGINAL ISSUE DISCOUNT IS 3.78625% PER ANNUM.

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY TO THE ISSUER OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY (AND ANY PAYMENT HEREON IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL SINCE THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

TRANSFERS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS IN WHOLE, BUT NOT IN PART, TO NOMINEES OF THE DEPOSITORY TRUST COMPANY, OR TO A SUCCESSOR THEREOF OR SUCH SUCCESSOR'S NOMINEE AND TRANSFERS OF PORTIONS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS MADE IN ACCORDANCE WITH THE RESTRICTIONS SET FORTH IN ARTICLE TWO OF THE INDENTURE REFERRED TO ON THE REVERSE HEREOF.

THIS SECURITY AND THE SHARES OF COMMON STOCK ISSUABLE UPON CONVERSION OF THIS SECURITY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR ANY STATE SECURITIES LAWS. NEITHER THIS SECURITY, THE SHARES OF COMMON STOCK ISSUABLE UPON CONVERSION OF THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN OR THEREIN MAY BE REOFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE

ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, REGISTRATION.

THE HOLDER OF THIS SECURITY, BY ITS ACCEPTANCE HEREOF, AGREES TO OFFER, SELL, OR OTHERWISE TRANSFER SUCH SECURITY, PRIOR TO THE DATE (THE "RESALE RESTRICTION TERMINATION DATE"), WHICH IS TWO YEARS AFTER THE LATER OF THE LAST DAY SECURITIES OF THIS ISSUE WERE ISSUED AND THE LAST DATE ON WHICH ALASKA AIR GROUP, INC. (THE "COMPANY" OR THE "ISSUER") OR ANY AFFILIATE OF THE COMPANY WAS THE OWNER OF THIS SECURITY (OR ANY PREDECESSOR OF SUCH SECURITY) ONLY (A) TO THE

A-1-1

COMPANY OR ANY SUBSIDIARY THEREOF, (B) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHICH NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (C) TO AN INSTITUTIONAL "ACCREDITED INVESTOR" WITHIN THE MEANING OF SUBPARAGRAPH (A) (1), (2), (3) OR (7) OF RULE 501 UNDER THE SECURITIES ACT THAT IS ACQUIRING THE SECURITY FOR ITS OWN ACCOUNT, OR FOR THE ACCOUNT OF SUCH AN INSTITUTIONAL "ACCREDITED INVESTOR," FOR INVESTMENT PURPOSES AND NOT WITH A VIEW TO, OR FOR OFFER OR SALE IN CONNECTION WITH, ANY DISTRIBUTION IN VIOLATION OF THE SECURITIES ACT, (D) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT OR (E) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT TO THE COMPANY'S AND THE TRUSTEE'S RIGHT PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER PURSUANT TO CLAUSE (C) OR (E) TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATION AND/OR OTHER INFORMATION SATISFACTORY TO EACH OF THEM, AND IN EACH OF THE FOREGOING CASES, A CERTIFICATE OF TRANSFER IN THE FORM APPEARING ON THE OTHER SIDE OF THIS SECURITY IS COMPLETED AND DELIVERED BY THE TRANSFEROR TO THE TRUSTEE. THIS LEGEND WILL BE REMOVED UPON THE REQUEST OF ANY HOLDER THAT IS NOT AN AFFILIATE OF THE COMPANY AFTER THE RESALE RESTRICTION TERMINATION DATE.

THE FOREGOING LEGEND MAY BE REMOVED FROM THIS SECURITY ON SATISFACTION OF THE CONDITIONS SPECIFIED IN THE INDENTURE.

A-1-2

ALASKA AIR GROUP, INC.
Senior Convertible Note due 2023

No. A-1 CUSIP: 011659 AF 6
Issue Date: March 21, 2003 Original Principal Amount: \$ _____
Issue Price: \$1,000.00
(for each \$1,000
Original Principal Amount)

ALASKA AIR GROUP, INC., a Delaware corporation, promises to pay to Cede & Co. or registered assigns, on March 21, 2023, the Variable Principal Amount of this Security on such date. This Security is issued with an Original Principal Amount of _____ DOLLARS (\$ _____).

This Security shall not bear interest except as specified on the other side of this Security. The Variable Principal Amount of this Security will accrue as specified on the other side of this Security. This Security is convertible as specified on the other side of this Security.

Additional provisions of this Security are set forth on the other side of this Security.

Dated: March 21, 2003 ALASKA AIR GROUP, INC.

By: _____
Name: Bradley Tilden
Title: Executive Vice President/Finance
& Chief Financial Officer

TRUSTEE'S CERTIFICATE OF
AUTHENTICATION

U.S. BANK NATIONAL ASSOCIATION,
as Trustee, certifies that this
is one of the Securities referred
to in the within-mentioned Indenture.

By: _____
Authorized Officer

Dated: March 21, 2003

A-1-3

[FORM OF REVERSE SIDE OF NOTE]
Senior Convertible Note due 2023

1. Interest.

The Company promises to pay interest in cash on the Original Principal Amount of this Note at the Variable Interest Rate set forth in the Indenture from the Issue Date, or from the most recent date to which interest has been paid or provided for, until March 21, 2008. During such period, the Company will pay cash interest quarterly in arrears on each Interest Payment Date to Holders of record at the close of business on each Regular Record Date immediately preceding such Interest Payment Date. Each payment of cash interest on the Securities will include interest accrued through the day immediately preceding the most recent Interest Payment Date.

Beginning March 21, 2008, this Security shall not bear interest, except as specified in this paragraph or in paragraph 11 hereof. From such date, the Original Principal Amount shall commence increasing daily by the Variable Yield to produce the Variable Principal Amount. The Variable Principal Amount will compound quarterly, not daily. At Stated Maturity, the Holder of this Security will receive the Variable Principal Amount of this Security on such date, unless the Security has been earlier redeemed or converted, which for each \$1,000 Original Principal Amount will be equal to such Original Principal Amount of \$1,000 per Security increased daily by the applicable Variable Yield as provided in the Indenture. If the Variable Principal Amount hereof or any portion of such Variable Principal Amount is not paid when due (whether upon acceleration pursuant to Section 6.02 of the Indenture, upon the date set for payment of the Redemption Price pursuant to paragraph 6 hereof, upon the date set for payment of the Purchase Price or Change in Control Purchase Price pursuant to paragraph 7 hereof or upon the Stated Maturity of this Security) or if installments of cash interest due hereon are not paid when due in accordance with this paragraph, then in each such case the overdue amount shall, to the extent permitted by law, bear interest at the Variable Interest Rate or Variable Yield, as the case may be, in effect following the date such overdue amount was due, compounded quarterly, which interest shall accrue from the date such overdue amount was originally due to the date payment of such amount, including interest thereon, has been made or duly provided for. All such interest shall be payable on demand. The accrual of such interest on overdue amounts shall be in lieu of, and not in addition to, any subsequent increase in the Variable Principal Amount.

The Holder of this Security is entitled to the benefits of a Pledge Agreement, dated March 21, 2003, between the Company and U.S. Bank National Association, pursuant to which the Company has placed in the Pledged Account cash or Pledged Financial Assets estimated to be sufficient to provide for the payment of the first twelve interest payments (up to and including the interest payment due on March 21, 2006) on this Security. The terms capitalized but undefined in this paragraph have the meanings given to them in the Pledge Agreement.

Interest on any Security that is payable, and is punctually paid or duly provided for, on any Interest Payment Date shall be paid to the person in whose name that Security is registered at the close of business on the Regular Record Date for such interest at the office or agency of the Company maintained for such purpose. Each installment of interest on any Security shall be

A-1-4

paid in same-day funds by transfer to an account maintained by the payee located inside the United States.

2. Method of Payment.

Subject to the terms and conditions of the Indenture, the Company will make payments in respect of Variable Principal Amount, Redemption Prices, Purchase Prices, Change in Control Purchase Prices and at Stated Maturity to Holders who surrender Securities to a Paying Agent to collect such payments in respect of the Securities. In addition, the Company will pay cash interest from the Issue Date until March 21, 2008, as more fully described in paragraph 1 hereof. The Company will pay any cash amounts in money of the United States that at the time of payment is legal tender for payment of public and private debts. However, the Company may make such cash payments by check payable in such money.

3. Paying Agent, Conversion Agent and Registrar.

Initially, U.S. Bank National Association (the "Trustee"), will act as Paying Agent, Conversion Agent and Registrar. The Company may appoint and change any Paying Agent, Conversion Agent and Registrar or co-registrar without notice, other than notice to the Trustee except that the Company will maintain at least one Paying Agent in the State of New York, City of New York, Borough of Manhattan, which shall initially be an office or agency of the Trustee. The Company or any of its Subsidiaries or any of their Affiliates may act as Paying Agent, Conversion Agent, Registrar or co-registrar.

4. Indenture.

The Company issued the Securities pursuant to an Indenture dated as of March 21, 2003 (the "Indenture"), between the Company and the Trustee. The terms of the Securities include those stated in the Indenture and those made part of the Indenture by reference to the Securities themselves and the Trust Indenture Act of 1939, as in effect from time to time (the "TIA"). Capitalized terms used herein and not defined herein have the meanings ascribed thereto in the Indenture. The Securities are subject to all such terms, and Securityholders are referred to the Indenture and the TIA for a statement of those terms.

The Securities are unsecured (subject to Article XIII of the Indenture) and unsubordinated obligations of the Company limited to \$150,000,000 aggregate Original Principal Amount (subject to Section 2.07 of the Indenture). The Indenture does not limit other indebtedness of the Company, secured or unsecured.

5. [Intentionally Deleted]

6. Redemption at the Option of the Company.

No sinking fund is provided for the Securities. The Securities are redeemable as a whole, or from time to time in part, at any time at the option of the Company in accordance with the Indenture at the Redemption Prices set forth below, provided that the Securities are not redeemable prior to March 21, 2006.

A-1-5

If redeemed at our option, the notes will be redeemed at the following prices, plus accrued and unpaid cash interest, if any, up to the Redemption Date:

- If redeemed between March 21, 2006 and March 20, 2007, at a Redemption Price equal to 102.16% of the Original Principal Amount of such Securities as of the applicable Redemption Date;
- If redeemed between March 21, 2007 and March 20, 2008, at a Redemption Price equal to 101.08% of such Securities as of the applicable Redemption Date; and
- If redeemed on March 21, 2008 or thereafter, at a price equal to 100% of the Variable Principal Amount of such Securities as of the applicable Redemption Date.

If this Security has been converted to a quarterly coupon note following the occurrence of a Tax Event, the Redemption Price will be equal to the

Restated Principal Amount plus accrued and unpaid interest from the date of such conversion to but not including the Redemption Date; but in no event will this Security be redeemable before March 21, 2006.

7. Purchase by the Company at the Option of the Holder.

Subject to the terms and conditions of the Indenture, the Company shall become obligated to purchase, at the option of the Holder, the Securities held by such Holder on March 21, 2008, March 21, 2013 and March 21, 2018 at a purchase price equal to the Variable Principal Amount of such Securities on the applicable Purchase Date plus accrued and unpaid cash interest, if any, upon delivery of a Purchase Notice containing the information set forth in the Indenture, at any time from the opening of business on the date that is 20 Business Days prior to such Purchase Date until the close of business on the day immediately preceding such Purchase Date and upon delivery of the Securities to the Paying Agent by the Holder as set forth in the Indenture.

The Purchase Price may be paid, at the option of the Company, in cash or by the issuance and delivery of shares of Common Stock of the Company, or in any combination thereof in accordance with the Indenture.

If prior to a Purchase Date this Security has been converted to a quarterly coupon note following the occurrence of a Tax Event, the Purchase Price will be equal to the Restated Principal Amount plus accrued and unpaid cash interest from the date of conversion to the Purchase Date as provided in the Indenture.

At the option of the Holder and subject to the terms and conditions of the Indenture, the Company shall become obligated to purchase all or a portion of the Securities in integral multiples of \$1,000 Original Principal Amount held by such Holder no later than 30 Business Days after the occurrence of a Change in Control of the Company for a Change in Control Purchase Price equal to the Variable Principal Amount of such Securities plus accrued and unpaid cash interest, if any, to but not including the Change in Control Purchase Date, which Change in Control Purchase Price shall be paid in cash. If prior to a Change in Control Purchase Date this Security has been converted to a quarterly coupon note following the occurrence of a Tax Event, the Change in Control Purchase Price shall be equal to the Restated Principal Amount plus accrued cash interest from the date of conversion to the Change in Control Purchase Date.

A-1-6

A third party may make the offer and purchase of the Securities in lieu of the Company in accordance with the Indenture.

Holders have the right to withdraw any Purchase Notice or Change in Control Purchase Notice, as the case may be, by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture.

If cash (and/or securities if permitted under the Indenture) sufficient to pay the Purchase Price or Change in Control Purchase Price, as the case may be, of all Securities or portions thereof to be purchased as of the Purchase Date or the Change in Control Purchase Date, as the case may be, is deposited with the Paying Agent on the Business Day following the Purchase Date or the Change in Control Purchase Date, as the case may be, the Variable Principal Amount shall cease to increase, and cash interest, if any, shall cease to accrue on such Securities (or portions thereof) on such Purchase Date or Change in Control Purchase Date, as the case may be, and the Holder thereof shall have no other rights as such (other than the right to receive the Purchase Price or Change in Control Purchase Price, as the case may be, if any, upon surrender of such Security).

8. Notice of Redemption.

Notice of redemption will be mailed at least 30 days but not more than 60 days before the Redemption Date to each Holder of Securities to be redeemed at the Holder's registered address. If money sufficient to pay the Redemption Price of, and accrued and unpaid cash interest, if any, with respect to, all Securities (or portions thereof) to be redeemed on the Redemption Date is deposited with the Paying Agent prior to or on the Redemption Date, on such Redemption Date, the Variable Principal Amount shall cease to increase, and accrued cash interest, if any, shall cease to accrue on such Securities or portions thereof. Securities in denominations larger than \$1,000 of Original

Principal Amount may be redeemed in part but only in integral multiples of \$1,000 of Original Principal Amount.

9. Conversion.

Subject to the provisions of this paragraph 9 and notwithstanding the fact that any other condition to conversion described below has not been satisfied, Holders may convert the Securities into Common Stock on a Conversion Date in any fiscal quarter commencing after June 30, 2003, if, as of the last day of the preceding fiscal quarter, the Sale Price of the Common Stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of such preceding fiscal quarter is greater than the conversion trigger price per share. The "conversion trigger price" for any fiscal quarter shall be 110% of the accreted conversion price per share (as defined below) of Common Stock on the last trading day of such preceding calendar quarter. If the foregoing condition is satisfied, then the Securities will be convertible at any time of the option of the Holder, through their maturity.

The "accreted conversion price per share" of Common Stock as of any day equals the quotient of:

- the Variable Principal Amount on that day, divided by

A-1-7

- the number of shares of Common Stock issuable upon conversion of \$1,000 Original Principal Amount of Securities on that day.

Conversion Based on Credit Ratings. Subject to the provisions of this paragraph 9 and notwithstanding the fact that any other condition described herein to conversion has not been satisfied, Holders may convert the Securities into Common Stock during any period in which the credit rating assigned to the Securities by a Rating Agency is reduced to or below the Applicable Rating. "Rating Agency" means (1) Moody's Investors Service, Inc. and its successors ("Moody's") or (2) Standard & Poor's Credit Market Services, a division of The McGraw-Hill Companies Inc. and its successors ("Standard & Poor's"). "Applicable Rating" means (1) Caal, in the case of Moody's (or its equivalent under any successor ratings categories of Moody's), (2) CCC+, in the case of Standard & Poor's (or its equivalent under any successor ratings categories of Standard & Poor's) or (3) the equivalent in respect of ratings categories of any Rating Agencies which are successors to Moody's or Standard & Poor's.

Conversion upon Redemption. Subject to the provisions of this paragraph 9 and notwithstanding the fact that any other condition described herein to conversion has not been satisfied, a Holder may convert into Common Stock a Security or portion of a Security which has been called for redemption pursuant to paragraph 6 hereof, provided such Securities are surrendered for conversion prior to the close of business on the second Business Day immediately preceding the Redemption Date.

Conversion Upon Certain Distributions. Subject to the provisions of this paragraph 9 and notwithstanding the fact that any other condition to conversion has not been satisfied, in the event that the Company declares a dividend or distribution described in Section 11.07 of the Indenture, or a dividend or a distribution described in Section 11.08 of the Indenture where, the fair market value, per share, of such dividend or distribution per share of Common Stock, as determined in the Indenture, exceeds 15% of the Sale Price of the Common Stock on the Business Day immediately preceding the date of declaration for such dividend or distribution, the Securities may be surrendered for conversion beginning on the date the Company gives notice to the Holders of such right, which shall not be less than 20 days prior to the Ex-Dividend Time for such dividend or distribution, and Securities may be surrendered for conversion at any time thereafter until the close of business on the Business Day prior to the Ex-Dividend Time or until the Company announces that such dividend or distribution will not take place. No adjustment to the Conversion Rate or the ability of the Holders to convert this Security will be made if the Company provides, as permitted in the Indenture, for Holders to participate in the transaction without conversion or in other cases specified in the Indenture.

Conversion Upon Occurrence of Certain Corporate Transactions. Subject to the provisions of this paragraph 9 and notwithstanding the fact that any other condition described herein to conversion has not been satisfied, in the event the Company is a party to a consolidation, merger or binding share exchange

pursuant to which the Common Stock would be converted into cash, securities or other property as set forth in Section 11.14 of the Indenture, the Securities may be surrendered for conversion at any time from and after the date which is 15 days prior to the date announced by the Company as the anticipated effective time until 15 days after the actual effective date of such transaction, and at the effective time of such transaction the right to convert a Security into Common Stock will be deemed to have changed into a right to

A-1-8

convert it into the kind and amount of cash, securities or other property which the holder would have received if the holder had converted its Security into Common Stock immediately prior to the transaction.

A Security in respect of which a Holder has delivered a Purchase Notice or Change in Control Purchase Notice exercising the option of such Holder to require the Company to purchase such Security may be converted only if such notice of exercise is withdrawn in accordance with the terms of the Indenture.

The initial Conversion Rate is 38.4615 shares of Common Stock per \$1,000 Original Principal Amount of each Security, subject to adjustment for certain events described in the Indenture. The Company will deliver cash or a check in lieu of any fractional share of Common Stock. The ability to surrender Securities for conversion will expire at the close of business on March 21, 2023.

In the event the Company exercises its option pursuant to Section 10.01 of the Indenture to have, in lieu of having the Variable Principal Amount increase, interest accrue on the Security following a Tax Event, the Holder will be entitled on conversion to receive the same number of shares of Common Stock such Holder would have received if the Company had not exercised such option.

Increases in the Variable Principal Amount and cash interest will not be paid on Securities that are converted; provided, however that, prior to March 21, 2008, Securities surrendered for conversion during the period from the close of business on any Regular Record Date next preceding any Interest Payment Date to the opening of business on such Interest Payment Date shall be entitled to receive such interest payable on such Securities on the corresponding Interest Payment Date and (except Securities with respect to which the Company has mailed a notice of redemption beginning on March 21, 2006 and thereafter) Securities surrendered for conversion during such periods must be accompanied by payment of an amount equal to the interest with respect thereto that the registered Holder is to receive.

To exercise its conversion right, a Holder must (1) complete and manually sign the conversion notice (or complete and manually sign a facsimile of such notice) and deliver such notice to the Conversion Agent, (2) surrender the Security to the Conversion Agent, (3) furnish appropriate endorsements and transfer documents if required by the Conversion Agent, the Company or the Trustee and (4) pay any transfer or similar taxes, if required.

A Holder may convert a portion of a Security if the Original Principal Amount of such portion is \$1,000 or an integral multiple of \$1,000. No payment or adjustment will be made for dividends on the Common Stock except as provided in the Indenture. On conversion of a Security, increases in the Variable Principal Amount or cash interest (or interest if the Company has exercised its option provided for in paragraph 11 hereof) attributable to the period from the Issue Date (or, if the Company has exercised the option referred to in paragraph 11 hereof, the later of (x) the date of such exercise and (y) the date on which interest was last paid) through the Conversion Date shall not be cancelled, extinguished or forfeited, but rather shall be deemed to be paid in full to the Holder thereof through the delivery of the Common Stock (together with the cash payment, if any, in lieu of fractional shares) in exchange for the Security being converted

A-1-9

pursuant to the terms hereof; and the fair market value of such shares of Common Stock (together with any such cash payment in lieu of fractional shares) shall be treated as issued, to the extent thereof, first in exchange for increases in the Variable Principal Amount or cash interest (or interest, if the Company has

exercised its option provided for in paragraph 11 hereof) accrued through the Conversion Date, and the balance, if any, of such fair market value of such Common Stock (and any such cash payment) shall be treated as issued in exchange for the Issue Price of the Security being converted pursuant to the provisions hereof.

The Conversion Rate will be adjusted for dividends or distributions on Common Stock payable in Common Stock or other Capital Stock; subdivisions, combinations or certain reclassifications of Common Stock; distributions to all holders of Common Stock of certain rights to purchase Common Stock for a period expiring within 60 days of the record date for such distribution at less than the Sale Price of the Common Stock at the Time of Determination; and distributions to such holders of assets or debt securities of the Company or certain rights to purchase securities of the Company (excluding certain cash dividends or distributions) and certain rights pursuant to shareholder rights plans. However, no adjustment need be made if Securityholders may participate in the transaction or in certain other cases. The Company from time to time may voluntarily increase the Conversion Rate.

If the Company is a party to a consolidation, merger or binding share exchange or a transfer of all or substantially all of its assets, or upon certain distributions described in the Indenture, the right to convert a Security into Common Stock may be changed into a right to convert it into securities, cash or other assets of the Company or another person.

The Conversion Rate will not be adjusted for increases in the Variable Principal Amount or accrued cash interest.

10. Conversion Arrangement on Call for Redemption.

Any Securities called for redemption, unless surrendered for conversion before the close of business on the Redemption Date, may be deemed to be purchased from the Holders of such Securities at an amount not less than the Redemption Price, by one or more investment bankers or other purchasers who may agree with the Company to purchase such Securities from the Holders, to convert them into Common Stock of the Company and to make payment for such Securities to the Trustee in trust for such Holders.

11. Tax Event.

From and after the date (the "Tax Event Date") of the occurrence of a Tax Event after March 21, 2008, the Company shall have the option to elect, in lieu of having Variable Principal Amount increase, to have interest accrue and be paid in cash at the Variable Yield per annum, on a Restated Principal Amount, per \$1,000 Original Principal Amount (the "Restated Principal Amount") equal to the accrued Variable Principal Amount through the Tax Event Date or the date the Company exercises the option provided for in this paragraph 11, whichever is later (the "Option Exercise Date"). Such interest shall be payable quarterly on March 21, June 21, September 21 and December 21 of each year to Holders of record at the close of business on March 7, June 7, September 7 and December 7 immediately preceding such interest payment

A-1-10

date. Interest will accrue from the most recent date on which interest has been paid or, if no interest has been paid, from the Option Exercise Date.

12. Defaulted Interest.

Except as otherwise specified with respect to the Securities, any Defaulted Interest on any Security shall forthwith cease to be payable to the registered Holder thereof on the relevant Regular Record Date or accrual date, as the case may be, by virtue of having been such Holder, and such Defaulted Interest may be paid by the Company as provided for in Section 12.02 of the Indenture.

13. Denominations; Transfer; Exchange.

The Securities are in fully registered form, without coupons, in denominations of \$1,000 of Original Principal Amount and integral multiples of \$1,000. A Holder may transfer or exchange Securities in accordance with the Indenture. The Registrar may require a Holder, among other things, to furnish appropriate endorsements and transfer documents and to pay any taxes and fees

required by law or permitted by the Indenture. The Registrar need not transfer or exchange any Securities selected for redemption (except, in the case of a Security to be redeemed in part, the portion of the Security not to be redeemed) or any Securities in respect of which a Purchase Notice or Change in Control Purchase Notice has been given and not withdrawn (except, in the case of a Security to be purchased in part, the portion of the Security not to be purchased) or any Securities for a period of 15 days before the mailing of a notice of redemption of Securities to be redeemed.

14. Persons Deemed Owners.

The registered Holder of this Security may be treated as the owner of this Security for all purposes.

15. Unclaimed Money or Securities.

The Trustee and the Paying Agent shall return to the Company upon written request any money or securities held by them for the payment of any amount with respect to the Securities that remains unclaimed for two years, subject to applicable unclaimed property laws. After return to the Company, Holders entitled to the money or securities must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person.

16. Amendment; Waiver.

Subject to certain exceptions set forth in the Indenture, (i) the Indenture or the Securities may be amended with the written consent of the Holders of at least a majority in aggregate Original Principal Amount of the Securities at the time outstanding and (ii) certain Defaults may be waived with the written consent of the Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding. Subject to certain exceptions set forth in the Indenture, without the consent of any Securityholder, the Company and the Trustee may amend the Indenture or the Securities to cure any ambiguity, omission, defect or inconsistency, or to

A-1-11

comply with Article 5 or Section 11.14 of the Indenture, to secure the Company's obligations under this Security or to add to the Company's covenants for the benefit of the Securityholders or to surrender any right or power conferred, in exchange for Holders agreeing to waive their right to require the Company to purchase all or a portion of their Securities on a specified Purchase Date, to add additional Purchase Dates on which Holders may require the Company to purchase all or a portion of their Securities at the applicable Purchase Price and, in addition, to pay such Holders additional cash payments in connection therewith, to comply with any requirement of the SEC in connection with the qualification of the Indenture under the TIA, or as necessary in connection with the registration of the Securities under the Securities Act or to make any change that does not adversely affect the rights of any Holders.

17. Defaults and Remedies.

Under the Indenture, Events of Default include (i) the Company defaults in payment of interest when due under the Securities and such default continues for 30 days, provided that a failure to make or provide for the payment in full of any of the first twelve scheduled cash interest payments on the Securities within three business days of the applicable Interest Payment Date will constitute an Event of Default with no additional grace or cure period if the proceeds from the Government Securities to be released from the Pledge Account prior to any such Interest Payment Date equal or exceed the cash interest, payable on such Interest Payment Date; (ii) default in payment of the Original Principal Amount, the Variable Principal Amount (or, if the Securities have been converted to quarterly coupon notes following a Tax Event, the Restated Principal Amount), Redemption Price, Purchase Price or Change in Control Purchase Price, as the case may be, in respect of the Securities when the same becomes due and payable; (iii) failure by the Company to comply with other agreements in the Indenture or the Securities, subject to notice and lapse of time; (iv) default in the payment of indebtedness when due resulting in acceleration of other indebtedness of the Company or indebtedness of the Company's Subsidiaries for borrowed money where the aggregate principal amount with respect to which the default and acceleration has occurred exceeds \$35,000,000, and such acceleration has not been rescinded or annulled within a

period of 10 days after receipt by the Company of a Notice of Default, subject to notice and lapse of time; (v) if any guarantee that may be provided pursuant to Section 4.07 of the Indenture with respect to the Securities ceases to be in full force and effect or is declared null and void or any guarantor denies that it has any further liability under any such guarantee, or gives notice to such effect (other than by reason of the termination of this Indenture or the release of any such guarantee in accordance with the applicable supplemental indenture) and such condition shall have continued for a period of 30 days after written notice of such failure requiring the guarantor and the Company to remedy the same shall have been given (x) to the Company by the Trustee or (y) to the Company and the Trustee by the holders of 25% in aggregate original principal amount of the Securities then outstanding; and (vi) certain events of bankruptcy or insolvency affecting the Company or certain of its subsidiaries. If an Event of Default occurs and is continuing, the Trustee, or the Holders of at least 25% in aggregate Original Principal Amount of the Securities at the time outstanding, may declare all the Securities to be due and payable immediately. Certain events of bankruptcy or insolvency are Events of Default which will result in the Securities becoming due and payable immediately upon the occurrence of such Events of Default.

A-1-12

Securityholders may not enforce the Indenture or the Securities except as provided in the Indenture. The Trustee may refuse to enforce the Indenture or the Securities unless it receives indemnity or security reasonably satisfactory to it. Subject to certain limitations, Holders of a majority in aggregate Original Principal Amount of the Securities at the time outstanding may direct the Trustee in its exercise of any trust or power. The Trustee may withhold from Securityholders notice of any continuing Default (except a Default in payment of amounts specified in clause (i) or (ii) above) if it determines that withholding notice is in their interests.

18. Trustee Dealings with the Company.

Subject to certain limitations imposed by the TIA, the Trustee under the Indenture, in its individual or any other capacity, may become the owner or pledgee of Securities and may otherwise deal with and collect obligations owed to it by the Company or its Affiliates and may otherwise deal with the Company or its Affiliates with the same rights it would have if it were not Trustee.

19. No Recourse Against Others.

A director, officer, employee, agent, representative, stockholder or equity holder, as such, of the Company shall not have any liability for any obligations of the Company under the Securities or the Indenture or for any claim based on, in respect of or by reason of such obligations or their creation. By accepting a Security, each Securityholder waives and releases all such liability. The waiver and release are part of the consideration for the issue of the Securities.

20. Authentication.

This Security shall not be valid until an authorized signatory of the Trustee manually signs the Trustee's Certificate of Authentication on the other side of this Security.

21. Abbreviations.

Customary abbreviations may be used in the name of a Securityholder or an assignee, such as TEN COM (=tenants in common), TEN ENT (=tenants by the entireties), JT TEN (=joint tenants with right of survivorship and not as tenants in common), CUST (=custodian), and U/G/M/A (=Uniform Gift to Minors Act).

22. GOVERNING LAW.

THE LAW OF THE STATE OF NEW YORK SHALL GOVERN THE INDENTURE, THE GUARANTEES AND THIS SECURITY.

A-1-13

The Company will furnish to any Securityholder upon written request and without charge a copy of the Indenture which has in it the text of this Security in larger type. Requests may be made to:

Alaska Air Group, Inc.
19300 Pacific Highway South
Seattle, Washington 98188
Attention: Chief Financial Officer

A-1-14

ASSIGNMENT FORM

To assign this Security, fill in the form below:

I or we assign and transfer this Security to

(Insert assignee's soc. sec. or tax ID no.)

(Print or type assignee's name, address and zip code)

and irrevocably appoint

_____ agent to transfer this Security on the books of the
Company. The agent may substitute another to act for him.

CONVERSION NOTICE

To convert this Security into Common Stock of the Company, check the box:

| |

To convert only part of this Security, state the Original Principal Amount to be converted (which must be \$1,000 or an integral multiple of \$1,000):

\$ _____

If you want the stock certificate made out in another person's name, fill in the form below:

(Insert other person's soc. sec. or tax ID no.)

(Print or type other person's name, address and zip code)

Date: _____ Your Signature: _____

(Sign exactly as your name appears on the other side of this Security)

A-1-15

EXHIBIT A-2

[Form of Certificated Security]

FOR PURPOSES OF SECTIONS 1272, 1273 AND 1275 OF THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED, THIS SECURITY IS ISSUED WITH AN INDETERMINATE AMOUNT OF ORIGINAL ISSUE DISCOUNT FOR UNITED STATES FEDERAL INCOME TAX PURPOSES. THE ISSUE DATE IS MARCH 21, 2003, AND THE YIELD TO MATURITY BASED ON A FIXED RATE EQUIVALENT FOR PURPOSES OF ACCRUING ORIGINAL ISSUE DISCOUNT IS 3.78625% PER ANNUM.

[INCLUDE IF SECURITY IS A CERTIFICATED SECURITY TO BE HELD BY AN INSTITUTIONAL ACCREDITED INVESTOR--IN CONNECTION WITH ANY TRANSFER, THE HOLDER WILL DELIVER TO THE REGISTRAR AND TRANSFER AGENT SUCH CERTIFICATES AND OTHER INFORMATION AS SUCH TRANSFER AGENT MAY REASONABLY REQUIRE TO CONFIRM THAT THE TRANSFER COMPLIES WITH THE FOLLOWING RESTRICTIONS.]

THIS SECURITY AND THE SHARES OF COMMON STOCK ISSUABLE UPON CONVERSION OF THIS SECURITY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR ANY STATE SECURITIES LAWS. NEITHER THIS SECURITY, THE SHARES OF COMMON STOCK ISSUABLE UPON CONVERSION OF THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN OR THEREIN MAY BE REOFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, REGISTRATION.

THE HOLDER OF THIS SECURITY, BY ITS ACCEPTANCE HEREOF, AGREES TO OFFER, SELL, OR OTHERWISE TRANSFER SUCH SECURITY, PRIOR TO THE DATE (THE "RESALE RESTRICTION TERMINATION DATE"), WHICH IS TWO YEARS AFTER THE LATER OF THE LAST DAY SECURITIES OF THIS ISSUE WERE ISSUED AND THE LAST DATE ON WHICH ALASKA AIR GROUP, INC. (THE "COMPANY" OR THE "ISSUER") OR ANY AFFILIATE OF THE COMPANY WAS THE OWNER OF THIS SECURITY (OR ANY PREDECESSOR OF SUCH SECURITY) ONLY (A) TO THE COMPANY OR ANY SUBSIDIARY THEREOF, (B) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHICH NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (C) TO AN INSTITUTIONAL "ACCREDITED INVESTOR" WITHIN THE MEANING OF SUBPARAGRAPH (A)(1), (2), (3) OR (7) OF RULE 501 UNDER THE SECURITIES ACT THAT IS ACQUIRING THE SECURITY FOR ITS OWN ACCOUNT, OR FOR THE ACCOUNT OF SUCH AN INSTITUTIONAL "ACCREDITED INVESTOR," FOR INVESTMENT PURPOSES AND NOT WITH A VIEW TO, OR FOR OFFER OR SALE IN

A-2-1

CONNECTION WITH, ANY DISTRIBUTION IN VIOLATION OF THE SECURITIES ACT, (D) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT OR (E) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT TO THE COMPANY'S AND THE TRUSTEE'S RIGHT PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER PURSUANT TO CLAUSE (C) OR (E) TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATION AND/OR OTHER INFORMATION SATISFACTORY TO EACH OF THEM, AND IN EACH OF THE FOREGOING CASES, A CERTIFICATE OF TRANSFER IN THE FORM APPEARING ON THE OTHER SIDE OF THIS SECURITY IS COMPLETED AND DELIVERED BY THE TRANSFEROR TO THE TRUSTEE. THIS LEGEND WILL BE REMOVED UPON THE REQUEST OF ANY HOLDER THAT IS NOT AN AFFILIATE OF THE COMPANY AFTER THE RESALE RESTRICTION TERMINATION DATE.

THE FOREGOING LEGEND MAY BE REMOVED FROM THIS SECURITY ON SATISFACTION OF THE CONDITIONS SPECIFIED IN THE INDENTURE.

A-2-2

ALASKA AIR GROUP, INC.
Senior Convertible Note due 2023

Issue Date: March 21, 2003
Issue Price: \$1,000
(for each \$1,000
Original Principal Amount)

Original Principal Amount: \$ _____

ALASKA AIR GROUP, INC., a Delaware corporation, promises to pay to Cede & Co. or registered assigns, on March 21, 2003 the Variable Principal Amount of this Security on such date. This Security is issued with an Original Principal Amount of _____ DOLLARS (\$ _____).

This Security shall not bear interest except as specified on the other side of this Security. The Variable Principal Amount of this Security will accrue as specified on the other side of this Security. This Security is convertible as specified on the other side of this Security.

Additional provisions of this Security are set forth on the other side of this Security.

Dated: March 21, 2003

ALASKA AIR GROUP, INC.

By: _____
Name: Bradley Tilden
Title: Executive Vice President/Finance
& Chief Financial Officer

TRUSTEE'S CERTIFICATE OF
AUTHENTICATION

U.S. BANK NATIONAL ASSOCIATION,
as Trustee, certifies that this
is one of the Securities referred
to in the within-mentioned Indenture.

By: _____
Authorized Officer

Dated: March 21, 2003

A-2-3

EXHIBIT B-1

TRANSFER CERTIFICATE

In connection with any transfer of any of the Securities within the period prior to the expiration of the holding period applicable to the sales thereof under Rule 144(k) (or any successor provision) under the Securities Act of 1933, as amended (the "Securities Act"), the undersigned registered owner of this Security hereby certifies with respect to \$ _____ Original Principal Amount of the above-captioned securities presented or surrendered on the date hereof (the "Surrendered Securities") for registration of transfer, or for exchange or conversion where the securities issuable upon such exchange or conversion are to be registered in a name other than that of the undersigned registered owner (each such transaction being a "transfer"), that such transfer complies with the restrictive legend set forth on the face of the Surrendered Securities for the reason checked below:

- | | The transfer of the Surrendered Securities is made to the Company or any subsidiaries; or
- | | The transfer of the Surrendered Securities complies with Rule 144A under the Securities Act; or
- | | The transfer of the Surrendered Securities is to an institutional accredited investor, as described in Rule 501(a)(1), (2), (3) or (7) under the Securities Act; or
- | | The transfer of the Surrendered Securities is pursuant to an effective registration statement under the Securities Act, or
- | | The transfer of the Surrendered Securities is pursuant to an

offshore transaction in accordance with Rule 904 under the Securities Act; or

| | The transfer of the Surrendered Securities is pursuant to another available exemption from the registration requirement of the Securities Act.

and unless the box below is checked, the undersigned confirms that, to the undersigned's knowledge, such Securities are not being transferred to an "affiliate" of the Company as defined in Rule 144 under the Securities Act (an "Affiliate").

| | The transferee is an Affiliate of the Company.

DATE: _____

Signature(s)

(If the registered owner is a corporation, partnership or fiduciary, the title of the Person signing on behalf of such registered owner must be stated.)

B-1-1

EXHIBIT B-2

FORM OF LETTER TO BE DELIVERED BY ACCREDITED INVESTORS

Alaska Air Group, Inc.
19300 Pacific Highway South
Seattle, Washington 98188

Attention: Chief Financial Officer

U.S. Bank National Association
1 Federal Street, 3rd Floor
Boston, Massachusetts 02110

Attention: Corporate Trust Services

Dear Sirs:

We are delivering this letter in connection with the proposed transfer of \$_____ Original Principal Amount of the Senior Convertible Notes due 2023 (the "Securities") issued by Alaska Air Group, Inc. (the "Company"), which are convertible into shares of the Company's Common Stock, \$1.00 par value per share (the "Common Stock").

We hereby confirm that:

(i) we are an "accredited investor" within the meaning of Rule 501(a)(1), (2) or (3) under the Securities Act of 1933, as amended (the "Securities Act"), or an entity in which all of the equity owners are accredited investors within the meaning of Rule 501(a)(1), (2) or (3) under the Securities Act (an "Institutional Accredited Investor");

(ii) the purchase of Securities by us is for our own account or for the account of one or more other Institutional Accredited Investors or as fiduciary for the account of one or more trusts, each of which is an "accredited investor" within the meaning of Rule 501(a)(7) under the Securities Act and for each of which we exercise sole investment discretion or (B) we are a "bank," within the meaning of Section 3(a)(2) of the Securities Act, or a "savings and loan association" or other institution described in Section 3(a)(5)(A) of the Securities Act that is acquiring Securities as fiduciary for the account of one or more institutions for which we exercise sole investment discretion;

(iii) we will acquire Securities having a minimum original principal amount of not less than \$250,000 for our own account or for any separate account for which we are acting;

(iv) we have such knowledge and experience in financial and business matters that we are capable of evaluating the merits and risks of

purchasing Securities; and

B-2-1

(v) we are not acquiring Securities with a view to distribution thereof or with any present intention of offering or selling Securities or the Common Stock issuable upon conversion thereof, except as permitted below; provided that the disposition of our property and property of any accounts for which we are acting as fiduciary shall remain at all times within our control.

We understand that the Securities were originally offered and sold in a transaction not involving any public offering within the United States within the meaning of the Securities Act and that the Securities and the Common Stock issuable upon conversion thereof (the Securities and such Common Stock hereinafter referred to as the "Securities") have not been registered under the Securities Act, and we agree, on our own behalf and on behalf of each account for which we acquire any Securities, that if in the future we decide to resell or otherwise transfer such Securities prior to the date (the "Resale Restriction Termination Date") which is two years after the later of the last day the Securities of this issue were issued and the last date on which the Company or an affiliate of the Company was the owner of the Security, such Securities may be resold or otherwise transferred only (i) to Alaska Air Group, Inc. or any subsidiary thereof, or (ii) for as long as the Securities are eligible for resale pursuant to Rule 144A, to a person it reasonably believes is a "qualified institutional buyer" (as defined in Rule 144A under the Securities Act) that purchases for its own account or for the account of a qualified institutional buyer to which notice is given that the transfer is being made in reliance on Rule 144A, or (iii) to an Institutional Accredited Investor that is acquiring the Security for its own account, or for the account of such Institutional Accredited Investor for investment purposes and not with a view to, or for offer or sale in connection with, any distribution in violation of the Securities Act, or (iv) pursuant to another available exemption from registration under the Securities Act (if applicable), or (v) pursuant to a registration statement which has been declared effective under the Securities Act and, in each case, in accordance with any applicable securities laws of any state of the United States or any other applicable jurisdiction and in accordance with the legends set forth on the Securities. We further agree to provide any person purchasing any of the Securities from us other than pursuant to clause (v) above a notice advising such purchaser that resales of such securities are restricted as stated herein. We understand that the trustee or the transfer agent, as the case may be, for the Securities will not be required to accept for registration of transfer any Securities pursuant to (iii) or (iv) above except upon presentation of evidence satisfactory to the Company that the foregoing restrictions on transfer have been complied with. We further understand that any Securities will be in the form of definitive physical certificates and that such certificates will bear a legend reflecting the substance of this paragraph other than certificates representing Securities transferred pursuant to clause (v) above.

We acknowledge that the Company, others and you will rely upon our confirmations, acknowledgments and agreements set forth herein, and we agree to notify you promptly in writing if any of our representations or warranties herein ceases to be accurate and complete.

B-2-2

THIS LETTER SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF NEW YORK.

(Name of Purchaser)

By: _____
Name:
Title:
Address:

C-1

ALASKA AIR GROUP PERFORMANCE BASED PAY PLAN
(formerly, the "Management Incentive Plan" or "MIP")

The Board of Directors (the "Board") of Alaska Air Group, Inc. (the "Company") has adopted a plan to reward employees of Alaska Airlines, Inc. ("Alaska") and Horizon Air Industries, Inc. ("Horizon"). The plan, formerly known as the Management Incentive Plan, has been renamed as the Performance Based Pay Plan ("Plan"). This memorandum is provided to explain the key elements of how the Plan will operate. The Performance Based Pay award ("Award") of each eligible Participant will depend upon the degree to which the Company achieves the performance goals set by the Compensation Committee of the Board for each calendar year (a "Plan Year") and the discretion of the Compensation Committee of the Board and Chief Executive Officer explained below. This Plan is effective beginning with the 2003 Plan Year and each year thereafter until amended, restated or terminated, pursuant to paragraph 8.

1. ELIGIBILITY

Eligibility to participate in the Plan during a Plan Year is limited to officers and other employees of Alaska and Horizon who (a) are designated by the Compensation Committee, and (b) are full-time employees of Alaska or Horizon as of the first day of January immediately following the end of the Plan Year, or (c) were full-time employees during the Plan Year and do not meet the requirement of (b) because their employment ended due to retirement at age 52 or older, disability or death (each a "Participant," or collectively "Participants"). Individuals may become Participants during the Plan Year if they are newly hired or promoted during the year and meet the requirements of the preceding sentence. Participants who are on temporary medical leave, military leave, or otherwise not working either full-time or part-time for Alaska or Horizon for reasons approved by the Board, but who remain employed, also retain eligibility as Participants. Participation in the Plan does not guarantee that any Award will be paid if applicable performance goals specified for the Plan Year are not achieved for the year. An individual whose employment with Alaska or Horizon ends for any reason not described in (c) above, such as resignation or termination, forfeits eligibility upon such end of employment.

1

2. BASIS FOR PARTICIPATION

A Participant's Basis for a Plan Year is used to determine the dollar amount of the Participant's Award for that year. The "Basis" is the actual Basic Salary of the Participant earned during the Plan Year multiplied by the percentage selected for that Participant by the Board. "Basic Salary" means the compensation earned by the Participant for services performed for Alaska or Horizon, INCLUDING amounts that the Participant could have received in cash had the Participant not elected to contribute the amount to an employee benefit plan maintained by Alaska, Horizon or the Company and any other voluntary payment the Participant makes which reduces his/her compensation (such as the Participant's voluntary contribution to an Internal Revenue Code ("Code") Section 401(k) Plan, Code Section 125 medical account, dependent day care spending account, or charitable gift), but EXCLUDING commissions, all awards (including any Award under this Plan), and all other forms of incentive or other supplemental pay, employee benefits paid by the employer (such as employer contributions to a Code Section 401(k) Plan), cash and non-cash fringe benefits and perquisites (such as auto allowance and travel reimbursement).

3. CALCULATION OF THE AWARD

The size of the Award earned for a Plan Year will depend upon the extent to which the performance goals of the Company have been achieved during that Plan Year and the discretion of the Compensation Committee of the Board. Separate performance weighting has been established for each performance goal. The Award will equal the dollar amount achieved by multiplying the Participant's Basis by the sum of the weighted percentage achievement factors, as adjusted in the Compensation Committee's discretion pursuant to paragraph 6. All calculations will be performed by

the Employee Services Department of Alaska and will be subject to approval solely by the Board. Once approved by the Compensation Committee of the Board, such calculations shall be conclusively presumed to be accurate.

2

4. PERFORMANCE WEIGHTING

In order to achieve any Award for a particular performance goal, a "Threshold" must be achieved. A full entitlement is achieved when the "Target" is reached, and a double entitlement is possible if the "Maximum" is achieved. This weighting applies to each goal individually. Once the Threshold is achieved, the percentage of the difference between the Threshold and Target achieved is multiplied by the weighting factor as specified in the attachment for the applicable Plan Year. If the Target is exceeded, the percentage of the difference between the Target and the Maximum achieved is multiplied by the weighting factor as specified in the attachment for the applicable Plan Year. Since the difference between the Threshold and Target is, in most cases, arithmetically different from the difference between the Target and the Maximum, calculations will be performed utilizing either the Threshold-Target range, or Target-Maximum range, as applicable, to locate the percentage of the Target, or the percentage of the Maximum, as applicable, that has been achieved.

5. PERFORMANCE GOALS AND APPLICABLE PERFORMANCE WEIGHTING FACTORS

The Compensation Committee of the Board will establish the performance goals for each Plan Year during the life of this Plan, and will provide an annex to this Plan that outlines goals and the weighting factors. Each such attachment will be labeled "Performance Based Pay Plan Goals and Measures for (year)" and distributed to Eligible Participants.

6. DISCRETIONARY FACTOR

In the case of a Participant described in paragraph 1(c) who retired due to age, terminated employment due to disability, or died during the year, or a Participant who took a leave of absence or worked a reduced schedule during any portion of the year, the Compensation Committee of the Board retains absolute discretionary authority to adjust the Award to such Participant based upon the Compensation Committee's determination of such Participant's contribution to the Company.

3

7. TIMING OF AWARDS

It is the intent of the Board to distribute the Award for a Plan Year no later than March 15 of the following year for each Plan Year that Participants have become entitled to an Award. A deceased Participant's Award will be paid to the beneficiary designated by the Participant for purposes of the Company's group term life insurance plan covering the deceased Participant, and in the absence of any designation, will be paid to the Participant's estate.

8. AMENDMENT

The Board, acting through the Compensation Committee, retains the right to modify the Plan in any manner that it deems appropriate, provided that it will not terminate the Plan for any Plan Year during that Plan Year unless it is clear that Participants will not receive an Award for that Plan Year. It is understood that the Compensation Committee of the Board will review the Plan yearly and may make changes to the Plan for the next Plan Year.

9. MISCELLANEOUS

- a. This memorandum, including its attachments, constitutes the entire understanding relating to an Award to any employee of Alaska or Horizon, and supersedes all prior oral or written agreements, representations or commitments relating to such Awards.
- b. This Plan is not a commitment of the Company, Alaska or Horizon, to any officer or employee of such company, to continue that individual

in its employ in order to qualify for an Award. Nothing contained in this Plan may be considered to be a promise of continued employment. Any employee who shall file suit against his or her employer for wrongful termination shall automatically cease to be a Participant.

- c. In the event that a Participant has a written employment agreement with Alaska or Horizon which entitles such Participant to participate in the Management Incentive Plan, this Plan is intended, for the purpose of such agreements, to be considered to be the same plan and may continue to be referred to as the MIP.

4

- d. This memorandum and the rights and obligations provided for herein shall be construed and interpreted in accordance with the law of the state of Washington, excluding its conflicts of law rules.
- e. No unpaid Award will be subject to the debts, liabilities, contracts or engagements of any Participant, and may not be alienated, pledged, garnished or sold, and any attempt to do so shall be void.

Dated January 1, 2003

Alaska Air Group, Inc.

R. Marc Langland
Chairman, Compensation Committee
Alaska Air Group, Inc. Board of Directors

5

CERTIFICATIONS

I, William S. Ayer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alaska Air Group, Inc. for the period ended September 30, 2004;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of September 30, 2004, based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2004

By /s/ William S. Ayer

William S. Ayer
Chairman, President & CEO

CERTIFICATIONS

I, Bradley D. Tilden, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Alaska Air Group, Inc. for the period ended September 30, 2004;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of September 30, 2004, based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9, 2004

By /s/ Bradley D. Tilden

Bradley D. Tilden
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Alaska Air Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William S. Ayer, Chairman, President & Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By /s/ William S. Ayer

William S. Ayer
Chairman, President & Chief Executive Officer
November 9, 2004

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Alaska Air Group, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bradley D. Tilden, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By /s/ Bradley D. Tilden

Bradley D. Tilden
Chief Financial Officer
November 9, 2004