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EDITED TRANSCRIPT

ALK - Q1 2014 Alaska Air Group, Inc. Earnings Conference Call

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OVERVIEW:

ALK reported 1Q14 GAAP net profit of $94m. 1Q14 adjusted net profit was $89m and adjusted diluted EPS was $1.28.

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PRESENTATION

Operator

Good morning. My name is May and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group's first quarter 2014 earnings conference call. Today's call is being recorded and will be accessible for future playback at ww.AlaskaAir.com.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session for analysts and journalists. (Operator Instructions). I would now like to turn the call over to Alaska Air Group's Managing Director of Accounting, Chris Berry. Sir, you may begin.

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Chris Berry - *Alaska Air Group, Inc. - Manager IR*

Thanks, May, and good morning, everyone. Thank you for joining us today for our first quarter 2014 earnings call. On the call today you will hear from our CEO Brad Tilden and our CFO Brandon Pedersen as they share some highlights from the first quarter and our outlook for the remainder of the year. Other members of our senior management team are also here to help answer your questions.

Our comments today will include forward-looking statements regarding future expectations, which may differ significantly from actual results. Information on our risk factors that could affect our business can be found in our SEC filings available on our website.

We will refer often to certain non-GAAP financial measures such as adjusted earnings or unit costs excluding fuel. We have provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in our earnings release.

This morning, Alaska Air Group reported a first-quarter GAAP net profit of $94 million. Excluding the impact of marked-to-market adjustments related to our fuel hedged portfolio, we reported a record adjusted net profit of $89 million compared to $44 million last year. On a per-share basis, the result translates to $1.28 per diluted share versus $0.62 in the first quarter of 2013, and compares favorably to the First Call consensus estimate of $1.24 per share.

Additional information about our unit cost expectations, capacity plans, capital expenditures, capital allocation, and other items can be found in our investor update included in our Form 8-K issued this morning and available on our website at AlaskaAir.com.

And now I will turn the call over to Brad.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Thanks, Chris, and good morning, everyone. Today marks another milestone for Alaska. It wasn't that many years ago that we created an objective of simply not losing money in the first quarter. Our business, like a lot of other airlines, have been very seasonal and, unfortunately, we have become used to digging the hole in the first quarter that we would have to dig our way out of in the second and third quarters.

Today we posted a substantial profit for the first quarter, essentially double last year's number and a result that would be strong for any quarter. The majority of the improvement is due to strong demand across our system and the revenue-enhancing initiatives such as the new credit card agreement and the increase in baggage and change fees that we put in place last year.

Our pretax margin for the quarter was 11.8%, up 550 basis points from last year. And our 12-month trailing return on invested capital was 14.8%, which is roughly twice our cost of capital. This strong first-quarter sets us up nicely for another good year.

Our revenue performance was matched by good cost control. Our people once again did a great job running a safe and on-time operation and they took excellent care of our customers. I want to thank them for their above-and-beyond efforts to defend our franchise and produce these results.

We are mindful of the growing capacity in Seattle, specifically from one large carrier. We believe our competitors' actions are creating a surplus of capacity in many of the markets we serve, which we will be dealing with until supply and demand come back into balance, which is something that we do believe will happen.

Alaska has many advantages which should help us in this battle. We have a safe and reliable operation where we focus on doing things right. We have a cost structure which is materially lower than the largest airlines and which enables us to offer lower fares.

We have an extremely loyal customer base, which is nurtured with our award-winning service. We have a diversified route network and we have a very strong balance sheet. In fact, S&P has commented recently that Alaska has the strongest financial profile of any US airline.

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Given these strengths, we expect to have strong financial performance in 2014, notwithstanding all of the new capacity. We are also taking several steps to ensure our success is sustained.

First, we are reallocating capacity to new destinations out of Seattle such as Tampa, Detroit, New Orleans, Albuquerque, Baltimore, and Cancun. These moves strengthen our position in Seattle as the airline that serves the most destinations and offers customers the greatest utility.

Second, we are reallocating capacity to new markets outside of Seattle, where additional capacity can bring new revenue into Air Group. In June we will be starting new service from Salt Lake City to seven cities in the West. We are optimistic about this new service and believe it will allow us to tap into new revenue.

We are funding this new service by exiting some underperforming markets not touching Seattle, such as Portland/Atlanta and Los Angeles/San Jose, and by increasing utilization.

Third, we are making our mileage plan even stronger. Members can already redeem miles for award travel to more than 700 global destinations, and they can earn Elite status faster on us than on any other frequent flyer program. We are now offering Elite qualifying miles on all international partners, meaning any trips our customers take on our international partners will count toward Elite status on Alaska. And we're offering double mileage in eight key competitive markets from Seattle.

And, finally, we continue to work on other initiatives that will improve our product offering and enhance loyalty as we face a challenging competitive environment in the months ahead.

Switching gears a bit, I am happy to report that Alaska's customers service agents, reservations agents, and accounting clerks recently ratified a five-year contract, and Horizon's dispatchers recently ratified a four-year contract. All of our work groups, with the exception of Alaska's flight attendants, who recently turned down a tentative agreement, now have long-term agreements in place. I want to thank our flight attendants for being very professional and for continuing to provide great service to our customers as we proceed through the negotiating process.

Three of our four largest represented groups now have contracts that extend through 2018 or later. This is a level of clarity in our labor structure that we haven't seen in years. We are proud of what we have been able to achieve working together with our unions to move this Company forward.

We are also proud to have shared the success of both Alaska and Horizon with our employees through our incentive program, which has averaged 8% of pay or roughly an extra month's wages, for the last five years.

We also know that to be successful long-term, we must ensure that shareholders get returns that are appropriate for the risks they assume. And they must get meaningful returns or distributions of capital. As you know, we have been leaders in this area, and we recently increased our dividend by 25% just six months after initiation.

We remain one of a few airlines paying a dividend and our yield is the highest of all US carriers. Brandon will talk more with you in just a moment about our cash flow generation and our thoughts on future capital returns.

We recognize that to be successful over the long-term, we have to do a lot of things right. We have to be safe and we have to offer low fares to our customers. Our leadership team and all of our employees have worked very hard to make this Company successful: by keeping our costs low, by building a strong and flexible network, by producing operating numbers that lead the industry, by providing great customer service, and by being nimble in responding quickly to changes in the marketplace. We believe that our customers appreciate these strengths and are staunchly loyal. And we believe that our employees embrace this plan and are aligned around it.

Finally, from what we hear from you when we speak with you on the road, we believe that our shareholders like our strategy and our execution, and we appreciate your continued support. In a nutshell, we are building a Company built on trust that will be here for the long-term and we plan to keep delivering.

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With that, I will now turn the call over to Brandon.

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Thanks, Brad and good morning, everybody. Air Group reported an adjusted net profit of $89 million compared to $44 million last year. Adjusted earnings per share more than doubled because of the growth in net income and a 3% reduction in diluted shares.

Our trailing 12-month return on invested capital grew to 14.8%, a 1.4 point improvement over the 12 months ended Q1 of last year. Our ROIC figure is fully taxed, and as Brad said, nearly double our weighted average cost of capital.

We are creating substantial economic value for our owners and will continue to do so. On an adjusted pretax basis, we reported a $144 million profit, which was $73 million better than last year's result.

On a capacity increase of 4.6%, total revenue climbed by $89 million or 8%, non-fuel operating expenses increased $35 million or 5%, and economic fuel expense was about flat. Our results also include $13 million in non-operating gains associated with the sale of an equity stake in an IFE provider and stock received in connection with American's bankruptcy.

Looking at revenues, we were pleased with the 1.7% improvement in PRASM that came despite the 7% increase in competitive capacity in our markets. Total RASM grew by 3.1%, reflecting the new bag and change fee structure that went into effect last year, and higher mileage plan revenue driven by a boost and economics from the Affinity card agreement modified last year and higher total spend on the card.

Generally speaking, unit revenues are under pressure in markets where we see increased competitive capacity and the resulting supply/demand imbalance. However, the schedule changes we have made in other areas of the network, along with improvement in newer markets, have helped to offset that weakness.

We also benefited from traffic that came to us from other airlines during storm-related cancellations and favorable rates used to determine how carriers settle up for this kind of traffic. We estimate that the additional revenue favorably impacted the Air Group PRASM gain by about 1 point.

Looking forward, we see strength in broad underlying demand and bookings for the spring are shaping up nicely. April should benefit from the Easter shift as well. Longer-term, however, we expect to see continued pressure on unit revenues because of the increase in competitive capacity. On a weighted average basis, we see competitive capacity up 8% in Q2, 7% in Q3, and 7% in Q4 of this year.

Turning to costs, CASM ex-fuel increased slightly on the 4.6% increase in capacity, quite a bit better than our initial guidance at the start of the quarter that cost would rise by more than 5%. Several factors explain the more favorable result.

First, and most importantly most in terms of impact, our people continued to do a great job managing costs. They know that maintaining and even widening our unit cost advantage is important as we compete with much larger network carriers.

Second, we saw a shift of certain costs out of Q1 into later quarters. This is especially true with some of the larger IT projects we have in process and our brand initiative. In total, we estimate that we had about $9 million shift to future quarters.

Third, our guidance assumed that the deal with the flight attendants would be ratified because we did have a tentative agreement in place at the time. Our full-year cost guidance now excludes the impact of a future deal with Alaska's flight attendants, which is more consistent with our historical practice, simply because we are unsure of the timing or amount. When and if we reach an agreement with our flight attendants, we will adjust our guidance accordingly.

Looking to the second quarter, we are expecting unit costs ex-fuel to be up about 1.5% on a 4.5% increase in ASMs. For the full year, we are now expecting ex-fuel costs to be about flat, which is better than our initial guidance back in January. We have a long track record of very good cost management and have reduced costs 11 out of the last 12 full fiscal years.

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Moving to the balance sheet, we ended the quarter with $1.4 billion in cash and short-term investments. We generated $249 million of operating cash flow in the first quarter compared to $212 million last year. The higher Q1 profit drove the increase.

Capital spending was approximately $93 million, resulting in a $156 million of free cash flow. We expect 2014 to be the fifth year in a row of strong free cash flow generation. We currently expect we full year CapEx to be between $530 million and $545 million. Even though our mainline fleet will only increase by three units this year, we are actually taking 10 very efficient 737-900 ERs and retiring seven older and smaller aircraft, further improving our fleet's efficiency.

We repurchased 350,000 shares of our stock for $30 million during the quarter, leaving just $50 million under our current $250 million authorization at quarter end. We still expect to return roughly $350 million to our owners this year through our dividends and share repurchase programs. We have been talking for a year now about our goal to be known as a high quality industrial company that has a balanced and shareholder friendly approach to capital allocation.

We make value-creating investments in our business. And, building on the practice we started in 2007, we return capital to our owners in a thoughtful and disciplined way, all while maintaining a strong balance sheet. Our numbers support that.

We ended the quarter with a 32% adjusted debt to cap ratio and in a $400 million net cash position.

Sometimes a picture is worth 1000 words. To that end, we included a chart in our investor update this morning that shows how our cash deployment has changed over the years. I want to point out two things about it. First, we have a long track record of making substantial but prudent investments in our business to fund growth, renew our fleet, add features like seats with power that benefit our customers, help reduce costs and strengthen our systems.

The second is that more and more of our cash flow is being used to ensure that our shareholders are getting an appropriate return.

I want to join Brad in congratulating all Air Group employees on a great first quarter and thanking them for what they do every day. And, with that, we are ready for your questions. As always, we have several members of the team here in the room to help us with the answers.

Operator, would you please let folks know how they can ask a question?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Hunter Keay.

Hunter Keay - *Wolfcamp Research - Analyst*

Brandon, I am at slide -- and, by the way, thank you, everybody, for reporting on a Friday. I had a ridiculous Thursday yesterday. That's a great move.

The slide where you talked about -- at Jamie's conference you guys showed $385 million of potential cash available to shareholders, now you are showing $350 million. And some things changed now. Your CapEx is about $55 million lower than it was on that slide. Your debt -- you went from inflows of $140 million to $117 million of payments.

So, a two-part question, Brandon. Your leverage is already below 40%. You said you don't want a three handle on that before. So why are you paying down more debt if you are going to be building equity, presumably, of earnings this year and paying down more debt? You are probably going to have a two handle on that leverage unless you add debt and deploy it back to equity holders.

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So, should we expect that $117 million of debt payments to actually swing and be an inflow of debt as you raise it to keep your leverage up?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Yes. Good morning, Hunter. The chart was really just meant to illustrate debt payments. It didn't reflect any expected increases in debt. We will very likely borrow this year, probably, I don't know, in the neighborhood of $100 million to $200 million.

And then the $350 million on the chart, that is meant to be an approximation. I don't think that you should interpret anything different between the $350 million on that chart, which we built up from First Call consensus, and the $385 million on the chart that I had at JPMorgan conference.

I think our point is to say, we are generating a considerable amount of free cash flow and we intend to use that in a way that benefits our owners. And the cash distribution opportunity for us is significant.

Hunter Keay - *Wolfcamp Research - Analyst*

Okay. Yes. That is totally fair. I just want to make sure that I am thinking about this properly in the sense that, if you are going to be raising debt, then, and your operating cash flow is going to be higher, I think it is probably fair to assume that $350 million is a baseline minimum that you guys feel comfortable committing to right now.

And, to that, and this is my last question, can you help us understand the mix of what it is going to be between dividends and repos? Thanks a lot.

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Sure. We have a dividend, as you know. We started it late or the middle of 2013. We increased it after just two quarters. And that dividend, cash flow wise, is about $70 million.

We recognize that high quality industrial companies like us have a very solid dividend and have a track record of increasing the dividend. We don't want to talk about specifics on that. What I can tell you is, just in terms of the proportional return, a much larger part of our cash distribution this year will come through share repurchase activity.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

And I think it is probably very clear, but the big point that we are hoping to make with this chart is that pensions are fully funded. We have spent hundreds and hundreds of millions of dollars over the last several years getting them to that point, but they are fully funded. And debt is largely paid down. The Company is in a net cash position. So as we have good cash flow from operations, the two opportunities are really investing in the fleet and returning capital to shareholders.

Operator

Savy Syth.

Savy Syth - *Raymond James - Analyst*

Couple of questions. Good job of highlighting how you are going to approach the competitive situation. I was just wondering how the history of competing fiercely and keeping your position in the Pacific Northwest, and -- but we haven't seen a competitor get to this level of market share from a seat perspective before. Is there a difference in competing against a position like that versus what you have seen historically?

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Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Savy, it is Brad. What do you mean by -- say a little bit more about what you mean about seat perspective.

Savy Syth - *Raymond James - Analyst*

So it looks like maybe they will get to about the high teens percentage of seats by the end of this year, out of Seattle. And in the past, I think, the largest competitor has maybe had 10% or 11% of seat share. And this is kind of larger presence in competing with a competitor with that much of a bigger presence.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Got you. Well, maybe I will start, and one of the things that I needed to say at some point in the call is Andrew Harrison is actually not with us today. He and his wife gave birth to a baby boy yesterday morning, so in his place we have got Ben Munson, our Director of Capacity Planning, and Miko Snyder, Director of Revenue Management. But I will maybe start on this question and we will ask Ben, in this case, if he wants to jump on and say something additional.

But, yes, I think -- the first thing to note is we do have a fair bit of overlap with Delta. If you look at that overlap, we can sort of break it into three different categories. First, a lot of it, they are growing a lot internationally out of Seattle, so wide bodies to -- I think this summer maybe 10 -- roughly 10 different destinations.

The second would be their airplanes that are really flying to their hubs, places they have always flown, places like Minneapolis and Detroit and Atlanta and Salt Lake and so forth. And the third is this new capacity that they are overlapping directly with us, which is really the share of their capacity that we are concerned with.

I guess, are we concerned about it? Yes, I think there is going to be more capacity in these markets than these markets need. And, as we said in our prepared remarks, we're going to be dealing with that.

And we have got a multi-point plan that covers our own network, where we are flying, the timing of our flights. It covers alliances. It covers our loyalty program, distribution, the whole gamut; our involvement in community, advertising and so forth. So yes, this is a very important strategic area that the Company is focusing on.

And I will say this is how capitalism in America works. I believe that we are going to get through this, and I believe this competition is going to make Air Group a stronger company. And we are looking forward to the next little bit.

Ben, I might ask you to sort of jump in and just comment a little bit on what you are seeking in terms of numbers in the marketplace.

Ben Munson - *Alaska Air Group, Inc. - Director, Network Planning*

Yes. For the first quarter, Delta was up about 12% in our markets in Seattle on an ASM basis. Looking forward it is where there is a bit more concern from a competitive pass seat side that will increase to close to 40% year-over-year by the fourth quarter.

And strategically, from a network side, we are kind of thinking about this with really a two-point strategy. One is on the market side, making sure that we have the best schedule. Not just against delta, but again all competitors and being the carrier of choice in markets like Seattle, L.A., Seattle-San Diego. But then also expanding the whole strategy in Seattle and then improving our customer proposition by adding six new nonstop destinations that Brad mentioned in his opening remarks, then just overall strengthening the hub here.

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Savy Syth - *Raymond James - Analyst*

Got it. That is helpful. And just a secondary question, wondering how the E190 flying in Alaska is doing.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Q400.

Savy Syth - *Raymond James - Analyst*

Q400. I apologize. (multiple speakers)

Glenn Johnson - *Alaska Air Group, Inc. - EVP (Alaska) & President (Horizon Air)*

This is Glenn Johnson. I am the president of Horizon. And we did take Horizon up to the state of Alaska, and we are flying a number of roundtrips between Anchorage and Fairbanks, and then also one round trip seasonally between Anchorage and Kodiak.

The objective of taking those airplanes up there, of course, was best match capacity with demand and so we were able to increase the daily run through frequencies in Anchorage-Fairbanks to an almost shuttle-like pattern from up to nine roundtrips a day.

And so we are very, very pleased, I think, with the initial introduction. A lot of work went in on behalf of both Alaska and Horizon setting up for that. And from both a customer perspective and then a community perspective, I think it's been very successful.

Ben Munson - *Alaska Air Group, Inc. - Director, Network Planning*

And I could actually just tag on to Glenn there and speak to the tag market economics and the introduction of the Q 400 into the state of Alaska in March in both Kodiak and Anchorage-Fairbanks has been really positive for the performance of both those markets.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Good. Thanks, Ben.

Operator

John Godyn.

John Godyn - *Morgan Stanley - Analyst*

Brad, I wanted to follow up on what is going on with Delta. And I know that the team has done a tremendous job in the face of this threat already. But we think about -- well, I guess there are two parts to this question.

First, if you could just talk about what inning you think we are in in Delta's expansion. And second, as we think about the very long-term implications of what is going on here, to what extent, when we think about Alaska five years from now, is this going to change what you look like?

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And I guess what I mean is, we have heard that you are expanding from Seattle to some other cities. You mentioned that in your prepared remarks. I wonder are we ever going to see Alaska with a new hub outside of Seattle.

Is there a point where we would have to revisit the long-term ASM growth rate that the Company is capable of doing? I am just curious what the very long-term implications of this threat might be as you see it.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

John, good question. In terms of what inning we are in, I don't think we are in a great position to say that. I -- we are not in the last half of the game. We know that.

Even if we look at 2014 in terms of -- I broke the market in the three categories early -- in terms of this group of markets where Delta is flying overlaps with us, 18 -- they have announced 96 flights for 2013 and 2014. And they are flying 18 of those today. So there is more service to come in the next two, three, four quarters than we have today.

In terms of the longer-term, I think one of the things that serves this Company really well over the last 10 or 15 years as the industry has gone through all sorts of strife, is sort of keeping our head down and focusing on what we can control and doing that stuff well.

And so, as we are trying to emphasize that stuff in the script, we do sort of have a basic belief that if we operate well, if we operate safely, if we operate on time, if we build alignment with our leadership team and our people and we all go out there and offer terrific service for the right fare, we think we are going to be okay. And as you look at what happened in 2003, 2004, 2005, 2006, this Company came through that in great form.

We have had a couple of big competitive onslaughts over the last 20 years that we have come through just fine. And I am very confident that we are going to come through this and, as I said earlier, come through this as a stronger Company.

In terms of how it plays out in what we look like in three, four, five years from now, I don't think there is a lot of return in speculating. And I will just point to a couple of reasons that there are now 42% or 43% of the Company are transcontinental Hawaii, we wouldn't have been able to get either of those three years in advance. So there is not a lot of return in guessing where we are going to be, but we are quite confident about where we are going to be.

John Godyn - *Morgan Stanley - Analyst*

In a world where the competitive threat continues to grow, can Seattle, as a main hub, sustain a 5% or so, like a mid-single digit ASM growth rate, are there enough accretive opportunities as you see it today?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Yes. Again, I don't think there is huge value in trying to predict the future. What I would say is that Alaska has grown at a rate that is considerably more rapid than the industry. We have grown maybe 2, 2.5 times the industry growth rate, if you go back 10 or 12 years.

And that growth comes from underlying economic growth and from stimulating markets or stealing share. We have done some of all three. I am confident about our prospects going forward.

Operator

Joe DeNardi.

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Joe DeNardi - *Stifel Nicolaus - Analyst*

Brad, on the CASM gap between you and the low-cost guys, it would appear, based on the guidance you have given relative to what they are providing, that the gap is going to continue to narrow. So I am just wondering how that influences your growth strategy.

If you get to a point where your cost structures are closer to one another, does that change the way you think about competing with them? Maybe you are a little bit more aggressive. Or should we think about that more as just a continued driver of margin expansion?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Hey, Joe. It's Brandon. Maybe I will take that one. Our folks have done an awesome job over the last 10 years reducing costs. It has been through a lot of hard work and a lot of different things. The fleet changes have played a huge part.

And that is an initiative that has been really important to us, as everyone on the call knows. It has done a lot to improve the advantage that we have over the network carriers and, you are right. Our costs are looking more like the low-cost guys.

In terms of what that means from a growth or competition standpoint or an opportunity standpoint, I think it does just continue to expand the number of places that we can fly to profitably. And we might use Cancun as an example.

We filed an application to start flying to Cancun. It is a market we had been in before. We have seen some improvement in the revenue environment, but our costs are lower, too. And that makes Cancun a good opportunity now versus one that we had to exit just a few years back.

It is something that also strengthens our utility out of Seattle. So, lower costs do strategically remain really important to us. And I think we have done a good job bringing those costs down.

Joe DeNardi - *Stifel Nicolaus - Analyst*

Okay. And then, on the branding initiatives, Brandon, I know that is important to you. Can you just kind of update us on how that is going and maybe how you are measuring the effectiveness, what type of metrics you are using?

Joe Sprague - *Alaska Air Group, Inc. - VP of Marketing*

Hey, Joe. This is Joe Sprague from marketing. So maybe I will take that one.

I would say the brand project is continuing at a measured pace. We got into this effort as a way to help attract even more customers in some of our growth markets. But, as we get into this even further, I think obviously we have to take into account the current competitive situation.

We do want the brand to be more compelling for new customers in new markets, but we need to maintain a strong loyalty of core market customers as well. So I would just say we are taking a measured pace. And as we continue to work through that in the next several months, one of the ways that we will certainly measure success of that is penetration in new markets, but also keeping a strong loyalty core here in our core markets in the Northwest.

Operator

Helane Becker.

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Helane Becker - *Cowen Securities LLC - Analyst*

Just two questions. One, with fuel prices being somewhat more stable, any thoughts to changing or modifying the hedge program?

Mark Eliason - *Alaska Air Group, Inc. - VP Finance & Treasurer*

This is Mark Eliason. We are looking at our hedging program and we did last year, as you know, make some substantial changes. We lowered the tenor and we were doing more out of the money hedging. We are going to take a strong look at it again this quarter, and stay tuned. I don't have anything to announce right now, but we are always cognizant of what we want to do.

We won't make major changes from the standpoint of we won't run away from our principals of treating hedging like insurance. And it is something that we buy and hope we don't use, because we hope fuel prices stay low and stay stable. So that is basically it. Don't have anything to report right now, but we will be looking.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

But, Mark, maybe to quantify it, and I think we have done this on other calls. We have gone from buying three years out to buying 18 months out -- and correct me if I am wrong -- and we have gone from buying half the money to 20% out of the money.

Mark Eliason - *Alaska Air Group, Inc. - VP Finance & Treasurer*

That is right.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

So our premium expenses has gone from what to what?

Mark Eliason - *Alaska Air Group, Inc. - VP Finance & Treasurer*

Gone to about from $60 million a year down to about $40 million from the steps we have taken now. And we could (technical difficulty) lower than that. That is what we are looking at.

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

And, Helane, this is Brandon. Just one more clarification. On the premium side, Mark is right. That is what is coming through the P&L this year, just because of the way we account for the options.

But in terms of the cash flow, perspective, if you look back at 2010, we were using $60 million, $70 million to buy options. This year we are going to spend about $10 million. So the amount we spend on hedging has gone way, way, way, way down because of these changes that we have made in our approach.

Helane Becker - *Cowen Securities LLC - Analyst*

That is awesome to know. Thank you.

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And then I just have one quick follow-up. I do know this, because I think you moved in Newark, because that day I flew home after seeing you guys a month or so ago, I went to a different terminal, right? I went to A instead of B. So can you just maybe update us on the cost and where that flowed through the income statement, and if you have moved now all over the East Coast?

Ben Minicucci - *Alaska Air Group, Inc. - COO and EVP Operations*

Yes. It is Ben Minicucci. Yes, we did 13 -- we had 13 moves to make in the first quarter; 12 out of the 13 are complete. We have one more, which is Boston, to be accomplished in several weeks. The moves have gone extremely well.

I have to really thank our airport folks, our IT folks, and our CRE folks -- our corporate real estate folks for doing a phenomenal job. And, yes, we did move in Newark.

And our costs -- a lot of the one-time costs -- the total costs of the moves are just shy of $5 million. But we will see on our recurring costs actually be lower because of the vendors we have put deals in with. So we are really looking forward to our new facilities and our new vendors.

Chris Berry - *Alaska Air Group, Inc. - Manager IR*

This is Chris. On a line item basis, a lot of that is in the contracted services line item where we have kind of doubled up on vendors during that move.

Helane Becker - *Cowen Securities LLC - Analyst*

Okay. So when we think about that, that line item isn't going to stay right at that level because you had double costs in the first quarter that you don't have -- that 13% increase. Is that what you mean?

Chris Berry - *Alaska Air Group, Inc. - Manager IR*

Well, there was some of that, but there is also, that is where we put our flying -- some of the regional flying out towards flying like Sky West. So that is ramped up as well, so that will be more of a permanent increase. But, yes, there is a little bit of a blip in there for some of this vendor move in different stations.

Operator

Duane Pfenningwerth.

Duane Pfenningwerth - *Evercore Partners - Analyst*

Can you help us understand the potential impact of your code being removed from competitive overlapping flights? It feels like you have done a great job so far of managing through this OA capacity growth, which obviously is, as you have articulated, gets a little bit worse over the next couple of quarters.

But, correct me if I am wrong. Is the loss of code revenue new? And can you just help us think about, is that an incremental impact or how do we think about that?

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Chris Berry - *Alaska Air Group, Inc. - Manager IR*

Duane, I can speak to that. We are seeking some slight impacts with the Delta relationship. We have shown, I think at the investor day, about $200 million of overall revenue exposure for a year from Delta. And I can say that our first quarter number was down about 5%.

We are making a lot about up with our other coach air relationships, in particular with the new American the first quarter. Revenues from that relationship were up over 20% year-over-year.

Duane Pfenningwerth - *Evercore Partners - Analyst*

That's helpful. Thank you. Just a housekeeping question. What was operating cash flow in the March quarter?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

$212 million, I believe. But let me check that, just a second; $249 million.

Duane Pfenningwerth - *Evercore Partners - Analyst*

Okay. Thanks, Brandon. And then, Brandon, just one more on the non-op line in Q2, obviously in the first quarter here you had some one-time or some found money. In the second quarter, how are you generating income on that line?

Mark Eliason - *Alaska Air Group, Inc. - VP Finance & Treasurer*

This is Mark Eliason. I can tell you that we still have some of the stock we got through that other airline bankruptcy to come through in Q2. You will see a little bit more of that. And then it is pretty much over.

Operator

(Operator Instructions) Glenn Engel, Bank of America Merrill Lynch.

Glenn Engel - *BofA Merrill Lynch - Analyst*

A couple questions. One, what was the Easter hit to you in March? And I assume a boost in April. And, two, you mentioned something about 40%, I thought, competitive capacity from Delta. In which markets are we seeing in some of the other markets, besides Delta, what is competitive capacity looking like?

Miko Snyder - *Alaska Air Group, Inc. - Director, Revenue Management*

This is Miko Snyder from revenue management. From Easter -- from March to April, March had a hit of about $7 million.

Unidentified Company Representative

And, Glenn, I could take the capacity question. So we mentioned that Delta is trending upward in our markets. But we are actually seeing really good capacity discipline from other carriers on the West Coast, in particular from United, from Virgin, and from Southwest, making pretty material reductions in our network.

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Glenn Engel - *BofA Merrill Lynch - Analyst*

And the Alaska market itself to 48 states?

Unidentified Company Representative

Alaska market is actually just about flat year-over-year. We have got some additions coming from Delta, but that is being offset by United has exited the Anchorage-Seattle market. And we are also seeing a lot less capacity in Anchorage, San Francisco this year. And Virgin has exited that market and United has reduced as well.

Glenn Engel - *BofA Merrill Lynch - Analyst*

And it seems like you have added a lot more destinations with not a lot of planes. So I assume that means fewer frequency. So is there a change in strategy favoring breadth over depth?

Unidentified Company Representative

So, some of those additions in the six markets maybe is what you are referencing from our Seattle Hub. That is really a combination of incremental units year-over-year and also reductions that we have had in our network in markets that were underperforming.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Glenn, I think we are up three units for the year. That is not a change, but I think we are up three airplanes year-over-year.

Unidentified Company Representative

Yes. That's correct. Yes.

Glenn Engel - *BofA Merrill Lynch - Analyst*

And, finally, you are talking about returning $350 million in cash this year on that chart or in the update. But you only did $50 million in the first quarter. Is this all going to be back end loaded, or what held you up in the first quarter?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

It is Brandon. No. The first quarter was low. I can say, though, is that we feel really comfortable with the cash flow this year. We are going to have a really strong year.

Sometimes, if you look in just three-month increments, you get pinched into things like board meetings and how you restructure a share repurchase grid, when blackout periods are, et cetera. But we would not have put that number out there in such a public way unless we were really comfortable with it. So what I can say is that we have been really good stewards of capital and we will keep our commitments.

Glenn Engel - *BofA Merrill Lynch - Analyst*

Well done.

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Operator

Daniel McKenzie.

Daniel McKenzie - *Buckingham Research - Analyst*

In general, we are seeing spend on corporate travel that accelerated modestly heading into the first quarter and heading into the second here. And the GBTA is calling for a 6% increase in spend for the second quarter. I'm wondering if you can comment on whether Alaska is getting its fair share of that travel spend from business travelers, just given some of the competitive dynamic that we are seeing.

Joe Sprague - *Alaska Air Group, Inc. - VP of Marketing*

Happy Friday, Dan. This is Joe again. Yes, is the simple answer. We are getting our fair share.

It is interesting, with Seattle, our route system is such that there is a number of places in our route system where we are not particularly well-suited for corporate travel. But Seattle is a definite exception to that. This is an area where we have always had strong utility for corporate accounts.

And it is unique because, for a relatively small city, there is obviously a large base of corporate travel here. So we have had years of building up relationships there and have good agreements in place with all the top corporate accounts in town. And I would say they are performing for Alaska very similar to the GBTA numbers that you referenced. And our expectation is that will continue through the rest of the year.

Daniel McKenzie - *Buckingham Research - Analyst*

Very good. And then if I could go back to the earlier comment about strengthening Alaska's position in Seattle, I'm wondering if you can just help clarify what that means, because it seems like you are obviously already strong in Seattle.

So I am just wondering where you -- what is the right way to characterize it, where you might need to go to feel like you have got the strength that you need. Is it perhaps in enhanced coach share with American that might help that? What are some levers you can pull to make Seattle where you would like it to be?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Dan, it is Brandon. Maybe I will start with the first part and then just in terms of future stuff, Joe chime in if I missed something. Our ads in Seattle are specifically designed to have Alaska be the carrier that operates in Seattle that goes the most places that people who live in Seattle want to go to. And we have added cities to achieve that objective over the last few years. You saw more in the recent quarter.

In terms of our interaction with other coach air partners, our strategies for a long time has been to have lots of partners that, through those partnerships, we can take our customers to more than 770 global destinations for the mileage redemption and for travel to other places. We have got a great suite of partners right now, but that might evolve over the years as it has in the past.

Operator

Steve O'Hara.

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Steve O'Hara - *Sidoti & Company - Analyst*

I guess I was just curious -- and in terms of the competitive moves in Seattle and so forth, do you think this is -- does this have the potential to maybe end capacity discipline as we know it? It seems like it's benefited the industry quite a bit, but it almost seems like an arms race in some ways, too, where first one carrier maybe thinks another one is getting a little too aggressive, maybe they have to start making their moves, too. Do you see it that way at all?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Steve, you guys are the analysts and I think it is probably a better question for you guys to sort of opine on.

What I would say is that it does -- and I think one of the benefits of the last decade has been the consolidation and the control overcapacity. And I do think that you see that nationally. I think that's a really positive -- that is a real positive for the industry.

And I think in Seattle we are -- I think there is going to be more capacity than we need for the next little bit. But I do also believe that we have been around for a long time. Water sort of (technical difficulty) finds its level. And so when you over-bake it, then it gets under-baked.

And so I think there might be some jostling around here in the next few quarters, but I guess I am confident the end of the day the right level of capacity will exist. And I am also confident in this Company's strengths, particularly in the Seattle market.

Steve O'Hara - *Sidoti & Company - Analyst*

Okay. And then just as a follow-up, did you talk about what you are seeing from the other competitors in Seattle as well? Is that -- those increases you were talking about, was that primarily just one carrier? Was that net of subtractions from others? Or what kind of actions are you seeing from the other carriers in Seattle?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

I am going to ask Ben Munson to chat a little bit about that, but I think it is fair to say that we are seeing more from Delta and we are seeking less from others. But, Ben maybe can provide a little bit more detail.

Ben Munson - *Alaska Air Group, Inc. - Director, Network Planning*

Yes, Brad, that is exactly right. So, just kind of looking forward maybe into the summer months, Delta capacity in Alaska markets in Seattle will be up 30%. We are actually seeing about an 8% reduction from other carriers in our markets.

Operator

Jamie Baker.

Jamie Baker - *JPMorgan - Analyst*

I thought I heard my name whispered there. I am not sure what that is about. I would echo Hunter's commentary. It is nice to see you monopolize a reporting day the same way that you monopolize double-digit pretax margins in the first quarter.

On to the question, I do agree that you can certainly take the stage with other high-quality industrial transports and stand shoulder to shoulder with most, if not all of those companies. The only obvious disconnect that emerges relates to your earnings multiple or lack thereof.

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I am not suggesting that you change course. But in the event that you don't eventually re-rate, if you continue to trade at a significant discount to these other high-quality transports, is there a plan B? Or actually, let me ask it another way. Does your multiple have a bearing on how you address capital deployment going forward, or is it merely an output that doesn't influence your behavior?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

Jamie, it is Brandon. That is a hard question, but I will give it a shot. We have always lagged on a multiple basis. And what we are focused on is just trying to do things right. We are trying to do things right from an operational perspective, from a customer perspective, and from a shareholder perspective.

And we are optimistic that folks will notice and we will get a multiple that we deserve, particularly given our performance and the balance sheet strength that we bring. And that is why we have been talking for 12 or more months about this notion of being high-quality industrial. We really want the market to understand this Company, its solid balance sheet, its great financial profile.

If you look back since 2009, we have generated $3.5 billion of operating cash flow and we have invested more than $2 billion into the business; more than $1.3 billion of free cash flow. We have brought our debt down from an 81% debt to cap to a 32% debt to capital. Our pensions are fully funded when they didn't have to be at all. And we have returned $440 million to shareholders.

So, as we go out on the road and we do these earnings calls and we talk to investors, we are hopeful that our multiple will catch up with this Company's actual performance.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Brandon, that is a great answer. The one thing I might add is that at the moment we are buyers of the stock. So there is a silver lining for owners, with the multiple being where it is.

Operator

Kevin Crissey.

Kevin Crissey - *Skyline Research - Analyst*

Sorry to go back to Delta; had three quick ones on this. With the routes that they have now added competitive capacity, were those more profitable than your system average and, therefore, were kind of more attractive in that regard? That's the first part.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

I don't think they are unique in any particular way.

Kevin Crissey - *Skyline Research - Analyst*

Okay. Would you expect those routes to remain profitable during this period for you guys?

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Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Again, we will have Ben to say something, but we are not really in the business of giving future forecasts on route profitability. But I do think in some of these routes there is going to be more capacity than would be ideal.

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

And, Kevin, it is Brandon. We don't, as you know, talk about specific market level profitability.

Kevin Crissey - *Skyline Research - Analyst*

How about for them? Are they going to lose money on those routes?

Brandon Pederson - *Alaska Air Group, Inc. - VP Finance & CFO*

You will have to ask them, Kevin. (multiple speakers)

Kevin Crissey - *Skyline Research - Analyst*

Well, I know what I'm going to hear when I ask them, but okay.

Operator

Michael Derchin.

Michael Derchin - *CRT Capital Group - Analyst*

I just wanted to ask you about your Switzerland strategy, alliance strategy and whether or not, looking longer-term, like 5 to 10 years out, and again, given -- assuming Delta does not continue, let's say, to be a major presence right in your home market. How do you go about considering looking at some of the other global alliances? Very specifically, a One World, which is the American, British Airways, clearly some of your issues you are having with Delta relates to you not wanting to drop relationships with these kind of carriers. So what is -- longer-term, can you talk about that Switzerland strategy versus going into a One World?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

This is Brad. It is a great question. Our thinking about these global alliances is that they work best when there is one carrier from each geography or from each country. Our issue is that we are a US domestic airline and we think that, given that, it makes a lot of sense for us to really occupy this position of being neutral with respect to the global alliances. We have to stand for something.

We have to have a brand, that has to matter that we are Alaska Air Group. We have got to have a vibrant mileage plan, the loyalty programs. All of those are things that help create demand or preference for our service and they help create the earnings that we are producing.

So I think it might -- we don't think believe it would be good for us to sort of be the number two domestic airline inside a global alliance, because I think you begin to lose your brand; your reason for being. I think you begin to lose the earnings capacity. So that is how we think about global alliances.

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Operator

Mike Linenberg.

Mike Linenberg - *Deutsche Bank - Analyst*

Brad, I want to go back to the point you made earlier. You talked about some of the capacity increases. And I apologize. This is a Delta question. So I'm just going to preempt it.

But, you indicated that the capacity that is going in is more than those markets need. But as you look out, because I realize some of these additions are coming in the summer and so, at least at this point, you can probably get a pretty early read on how the leisure bookings are starting to build.

Are you seeing anything, though? Is there really anything out there, I mean, pressure on fares? Or, at this point, is it still too early?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Mike, I think it's probably early. We actually see it -- and, I think, again, we are going to refrain from talking too much about the segment results. It is too far in the future.

But I would say it is pretty early. In the next little bit, business conditions actually look pretty good to us going into the spring and summer. This is part of a long-term situation of just how much natural demand is there in a market and the city for average between point A and point B and how many airplane seats should be in that market. That is kind of a high level, longer-term concern.

Mike Linenberg - *Deutsche Bank - Analyst*

Okay. And then if we can go back to last year, there was -- initially, there was a bit of a buildup. I mean, there were some additions by Delta, but also others as well.

So now that we have that data, I mean, and I'm sure you have looked through it carefully, were you able, overall, to maintain your revenue premium? I mean, did you -- the degradation that maybe you thought would have happened and maybe it just didn't happen because the numbers seem to have borne out otherwise.

Unidentified Company Representative

Yes. I can take that, Mike. And I think what has been really good, whether it was last year or this year, is one thing we have been, I think, great about is really diversifying the network and getting strong results kind of across the board. And what we have seen -- we had this in 2013 and we are experiencing this in 2014 as well, is when we do have competitive pressures in one area, we have had improvements in other regions to offset those.

Mike Linenberg - *Deutsche Bank - Analyst*

Okay. Great. And then, just last thing, I can just squeeze in a personal question. This is kind of following up on Helane.

The 13 airport moves that you had, I realize for some of them you did have access to the Delta Club. Were you able to preserve club access in all those moves? And I am -- presumably, it is with American.

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Joe Sprague - *Alaska Air Group, Inc. - VP of Marketing*

Hey, Mike. This is Joe. Our agreement with Delta for the Sky Club reciprocal access remains in place. Obviously, with some of those gate moves, the geography at the airport no longer works. And so, to the greatest (technical difficulty) possible in each case, and it varies by airport a little bit, we have tried to find another partner, another club room partner with which we can still offer access for our Alaska Airlines board room members.

So I think most all the airports still have some sort of club room access in place where it had it before.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Okay, May, we have time for one more question.

Operator

Tom Vance.

Tom Vance - *KUOW Radio - Analyst*

I wanted to just hit some of the themes we have talked about over this hour, but more from a consumer or frequent flyer perspective. I am noticing on social media and other places like Flyer Talks online chat room that a lot of Alaska's frequent flyers are predicting the imminent demise of Alaska's partnership with Delta Airlines. What can you say about that prediction?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Good morning, Tom. This is Brad. Again, I would say that there is not a lot of value in trying to guess the future. What I would say -- and I appreciate the question -- we have a really loyal base of customers in Seattle that we have sort of nurtured and built up over many, many years. And we appreciate their loyalty.

We are going to work really hard to make sure that our offerings are very, very compelling. And that includes everything from the cities we fly to the times we fly, the partnerships we have, and all of that. So I think the Delta thing will sort of play itself out in due course and, when it does play itself out, we will have more to say about that.

But I do want to say we are very committed to the Seattle marketplace and to ensuring that Alaska has just the very best offerings across the board for our Seattle-based customers.

Tom Vance - *KUOW Radio - Analyst*

But, what would you say is keeping that partnership together at this point?

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

You know, there are limits to what we can talk about, but we are in the midst of a long-term agreement. We have a long-term contract with Delta right now.

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Tom Vance - *KUOW Radio - Analyst*

Thank you.

Brad Tilden - *Alaska Air Group, Inc. - Chairman, CEO, President*

Okay. I think that is the end of the questions. We appreciate everybody dialing in and listening, and we look forward to talking with you three months from now. Thanks.

Operator

Thank you for participating in today's conference call. This call will be available for replay beginning at 2:00 p.m. Eastern Time today through 11.59 p.m. Eastern Time on May 25, 2014. The conference ID number for the replay is 24156661. The number to dial for the replay is 1-855-859-2056 or 1-404-537-3406.

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