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CORPORATE PARTICIPANTS

Lavanya Sareen *Alaska Air Group, Inc. - Managing Director, IR*

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

Andrew Harrison *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Brandon Pedersen *Alaska Air Group, Inc. - EVP, Finance & CFO*

Shane Tackett *Alaska Air Group, Inc. - VP, Revenue Management*

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

Joe Sprague *Alaska Air Group, Inc. - SVP, Communications and External Affairs*

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

CONFERENCE CALL PARTICIPANTS

Savi Syth *Raymond James & Associates - Analyst*

Rajeev Lalwani *Morgan Stanley - Analyst*

Julie Yates *Credit Suisse - Analyst*

Hunter Keay *Wolfe Research - Analyst*

Michael Linenberg *Deutsche Bank - Analyst*

Helane Becker *Cowen Securities - Analyst*

Jamie Baker *JPMorgan - Analyst*

Darryl Genovesi *UBS Securities - Analyst*

Duane Pfennigwerth *Evercore ISI - Analyst*

Andrew Didora *BofA Merrill Lynch - Analyst*

David Simpson *Barclays Capital - Analyst*

Dan McKenzie *Buckingham Research Group - Analyst*

PRESENTATION

Operator

Good morning. My name is Melissa and I will be your conference operator today. At this time I would like to welcome everyone to the Alaska Air Group fourth-quarter and full-year 2015 earnings conference call.

Today's call is being recorded and will be accessible for future playback at www.AlaskaAir.com. (Operator Instructions)

I would now like to turn the call over to Alaska Air Group's Managing Director of Investor Relations, Lavanya Sareen.

Lavanya Sareen - *Alaska Air Group, Inc. - Managing Director, IR*

Thanks, Melissa, and good morning, everyone. Thanks for joining us for Alaska Air Group's fourth-quarter and full-year 2015 earnings call.

On the call today our CEO, Brad Tilden, will provide an overview of the business; our Chief Commercial Officer, Andrew Harrison, will share the revenue results for the fourth quarter and full year; and then Brandon Pedersen, our CFO, will discuss our financial results for 2015 and outlook for 2016. Several members of our senior management team are also on hand to help answer your questions.

As a reminder, our comments today will include forward-looking statements regarding our future expectations, which may differ significantly from actual results. Information on risk factors that could affect our business can be found in our SEC filings. We will refer to certain non-GAAP financial measures, such as adjusted earnings and unit cost excluding fuel. We've provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in our earnings release.

This morning Alaska Air Group reported a fourth-quarter GAAP net profit of $191 million. Excluding mark-to-market fuel hedge losses and certain other items that netted to $5 million, the Company recorded fourth-quarter 2015 net income of $186 million, or $1.46 per diluted share. This result compares to First Call estimate of $1.40 per share and exceeds last year's adjusted net income of $125 million or $0.94 per diluted share.

For the full year, Air Group reported a record adjusted net profit of $842 million. That's up 47%. Earnings per share grew 56% to $6.51 per share, with the incremental growth driven by the significant number of shares repurchased during the year. Additional information about cost expectations, capacity plans, fuel hedging, capital expenditures, 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 with that I will turn the call over to Brad.

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

Thanks, Lavanya, you, and good morning, everyone. I'm sure that you have all seen our results by now and have seen that 2015 was a record year on almost every front.

While every airline has benefited from low fuel prices, Alaska led the industry in many of the underlying drivers of financial performance: areas like operational reliability, customer satisfaction, customer growth, and low fares/low cost. These are the areas that represent our competitive advantage, or our economic moat, and they are also the reasons that our financial performance is what it is. I would like to start the call by covering a few of these areas.

First, safety. We've reduced what we call our risk level three events dramatically over the last five years and over the same time period our lost-time injuries are done more than 25%. We are by no means perfect and safety events, no matter how small, remind us of the enormous responsibility we have towards our customers, our employees, and their families.

And, again, a focus on doing things safely is also a focus on doing things right and that benefits everyone.

Operationally, Alaska leads the industry. Notwithstanding a tough December at Horizon, 86.1% of our flights in 2015 arrived on time and that resulted in Alaska being named the number one North American carrier by FlightStats for the sixth straight year. We also led the industry with the fewest number of customer complaints and our completion rate of 99.5% was second among the nine largest domestic airlines. This performance led to the Wall Street Journal rating us the top airline for the third year in a row and for the fourth out of the last five years.

I want to thank Ben and Dave, together with their operational leaders and all of our front-line employees, for their focus on getting it right with more than 900 flights every single day.

Moving to the next item, in 2015 our internal measure of customer satisfaction reached a new record high of 86%, a 2 points improvement over last year and a remarkable 16 point increase since we began collecting this data in 2007. We know that satisfied customers have contributed to record growth in both our mileage plans and our credit card. Considering how established these programs are, these record growth rates are extraordinary and they are a huge credit to our people.

We've spoken to you in the past about Beyond Service, a two-day customer service workshop for our front-line employees. We have now completed all 66 classes. Longtime company leaders Andy Schneider, Diana Shaw, and Jeff Butler led this fantastic effort and I want to both thank and congratulate them and their teams, who put in countless hours putting these classes together. I believe this program is already moving the needle in terms of how we focus on our customers.

On the labor front, with our new dispatcher contract, we are the only US airline to have no open contracts at this time. The weighted average duration of our agreements is almost three years, which compares very favorably to the rest of the industry.

As folks have said before, the airline business is the ultimate team sport, and for an airline to run well, the team has to work together. As you know, this is an area where we spend a lot of time and our people are incredibly proud of what they've built at Alaska. Our employee engagement scores and our top 100 ranking in the Forbes' Employer Survey are a testament to this.

We're also very proud that when our company does well our employees benefit. Every employee at Air Group participates in the same gain-sharing plan which we call PBP. This program, combined with our monthly operational bonus program, will pay out a record $120 million this year with $98 million of this being paid to our employees tomorrow.

This is the seventh consecutive year where our employees will get a full month's pay in performance bonuses. This alignment is very powerful and we believe it will do nothing but benefit us in future years.

So those areas, combined with our low fares and low costs, our strong balance sheet, and our simple and profitable fleet, represent our competitive advantage. Our performance in these areas, together with low fuel prices, drove our financial results and I would like to highlight those now.

As Lavanya said, our net income for the quarter was $186 million, up 49% from 2014, and for the year it was $842 million, up 47%. Our pretax margin expanded 680 basis points to 24% for the year and our ROIC for the trailing 12 months of 25.2% is more than 3 times our cost of capital. We expect these results will put our pretax margin and ROIC both in the top 10% of the S&P 500.

Our cash flows from operations were almost $1.6 billion. Free cash flow was $760 million, and of this total, over $600 million was returned to shareholders. We bought back 5.5% of our stock this year and we bought back 35% since 2007.

We were very excited to announce this morning our third dividend increase in the last two and half years and with today's announcement, our dividend yield is 1.6%, bringing us closer to our goal of having a dividend that resembles high-quality industrials. And with respect to the quality and diversity of our route network, I thought you might be interested in knowing that even if we adjusted our fuel prices to $3 a gallon, markets representing 95% of our revenue would still be profitable.

2015 was a great year for all of our constituents: customers, employees, communities, and owners. And, as you know, this continues a longer-term trend, so we feel good about our performance.

There's obviously some concern in the industry about the revenue environment. And on that score, I would like to say that we are quite optimistic about 2016 and we feel good about both our geographies and our customer segments. 90% of our revenue is generated in the domestic US market, which is a good place to be, and two-thirds of our revenue has a leisure focus, which is more resilient in a downturn and more stable through the cycle.

As we move forward in 2016, we're focused on a number of new initiatives which we expect will bring value to both customers and shareholders. These include launching our new premium economy product; continuing to reconfigure our fleet with renewal of the 737 fleet at Alaska and preparation for the possible introduction of regional jets at Horizon; growing the 20 new markets that we added in 2015; enhancing our alliance relationships, primarily in the international arena; better marketing our mileage plan and credit card, which have new benefits for members; and, finally, further lowering our cost structure and making our fare advantage better known to customers.

As I close, I want to thank our team of 15,000 people for an incredible year. With that, I will turn the call over to Andrew.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Thanks, Brad, and good morning, everyone. We were very pleased with our 2015 passenger revenue, which grew 4.7%. This is in contrast to the industry's revenue decline of 1%. We were within 1 point of industry unit revenue performance, despite competitive capacity headwinds of 12%.

For the fourth quarter our revenue was up 5.5% against a backdrop of 9% increase in competitive capacity. That drove our PRASM down 6.6%, but well within our expectations. We added 18 new markets in the second half of 2015 and 11 of those were in the fourth quarter. This is the largest number of new markets added in any single quarter in over a decade.

We understand there continue to be questions around our growth, so we went back and looked at a few data points that I want to share with you. These reinforce for us that we continue to take the right actions.

First, our launch of 20 new markets over the last year brings our total North America destinations served from Seattle to 86. That's more than 2 times our closest competitor at 39. Now this creates the best schedule utility for customers in Seattle and the Pacific Northwest.

Second, notwithstanding a competitive onslaught, our growth has helped us maintain our Seattle market share at 51%. This is unchanged from three years ago and our Seattle hub is performing exceptionally well.

Third, our new markets are maturing quickly. The portfolio of new markets launched in the last 12 months are profitable. More importantly, half of these markets have only operated for one quarter, being our seasonally weakest, Q4.

And then finally, as we highlighted at investor day, over the last five years we have added 90 markets; grown capacity at a compounded annual growth rate of 7.6% and revenue at 7.9%. Industry's revenue grew at a rate of less than 3% over the same period.

If you are asking, Andrew, what is your point here? The point is this: our total capacity growth over the past five years accounts for $1.8 billion, or a third of our revenues. Margins on this revenue are in line with system average. Said another way, our earnings per share would be approximately $2 lower than that we've reported today had we decided to keep capacity flat.

The bottom line is this. Growth has been good for our customers, our employees, and unquestionably, for our shareholders. We believe that a thoughtful growth as a low-cost carrier that enjoys strong customer loyalty will increase our network utility, diversify our revenue base, and create durable earning streams. These outcomes far outweigh the short-term impact of RASM comps, which we are experiencing today, and we will likely see through the first half of 2016.

Moving to the performance of the broader commercial business, our partnerships are growing. Over the last year, we provided our customers with access to an incremental 60 international destinations and 3,600 flights per day on which to earn and redeem miles. In fact, passengers on Alaska medal coming from Hainan, Iceland Air, and Emirates increased 43% in the fourth quarter as a result of our new agreements coupled with our partners' expanded service.

Customer loyalty is growing at unprecedented rates, even in the face of competition. Active mileage plan members are up 15.5% this year, outstripping passenger growth of 8.9%. This is the second consecutive year of double-digit growth in our mileage plan members.

More impressive, our Elite members grew 19%, pointing to increase stickiness with our brand. And our credit card members increased 11.6%, making 2015 the strongest year for card member growth since we started tracking this data.

Our affinity program generated nearly $700 million of cash flow in 2015 and will continue to grow in 2016.

Speaking of 2016, I wanted to remind you of two very important initiatives that we announced at an investor day in December that will further grow our revenue. First, we will introduce a premium class product on our 737s and our regional jets, adding at least $85 million in annual profit by 2018. We will start to retrofit existing aircraft in the second half of 2016 and we will complete 75 aircraft by year-end.

Second, our new agreement with Bank of America will add $60 million in new annual revenue starting in the first quarter of 2016. And our affinity Visa card offers industry-leading benefits like no first bag fee, no international transaction costs, a companion fare, and the lowest annual fee amongst comparable cards. We are confident that are card will remain top-of-wallet for existing holders and help us continue to grow the cardholder base and related revenues.

Then, finally, we will be adding two more regional jets to our network this month to fill a market need for an aircraft that can serve longer haul markets with demand that doesn't justify a 737. We will also be replacing our eight CRJ700s with Embraer 175s, as they have an 8.5% more capacity and allow us to sell premium seats and give us greater range.

This is an area where we think we have plenty of room for profitable growth in 2016 and beyond.

The four markets we've launched thus far are already profitable within six months of launch and Brandon is going to talk a bit more about this in a moment.

Looking forward at capacity growth, Q1 is expected to be up 13.5% given a heavy new delivery schedule that meters down to 10.8% as we enter the seasonally-strongest second quarter and we move to retire our 737-400s. Today I am reiterating our 2016 full-year growth expectation of 8%. We expect growth in the second half of 2016 to be in the neighborhood of 5%.

Moving to competitive capacity, other airline capacity, competitive capacity is expected to be up 13% and 12% in Q1 and Q2, respectively. To reiterate what Brad said, we are optimistic about 2016. Underlying demand in our geographies is strong, new markets continue to deliver, and loyalty and credit card programs are growing.

The new revenue initiatives we are implementing will deliver an annual run rate of $150 million. This gives us confidence that our growth is sound and that we will continue to deliver on shareholder returns.

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

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Thanks, Andrew, and good morning, everyone. As Brad said, fourth-quarter adjusted earnings grew by 49% to $186 million and earnings per share grew by 55% to $1.46 per share. The record fourth-quarter result brings our full-year net profit to $842 million and earnings per share to $6.51 per share. Earnings per share has almost doubled since 2012, even in the face of unprecedented competition in our Seattle hub since that time.

Similarly, our after-tax return on invested capital has grown from 13% in 2012 to 25.2% this year. Our net operating profit has more than doubled over that period, yet our invested capital base has grown by only 11%. We expect our ROIC to lead about 90% of the companies in the S&P 500 and all but 10 industrials in the Index.

Fourth-quarter pretax profit grew by $86 million, led by a $100 million decline in economic fuel costs. We recognize that low fuel prices will probably not last forever, so we remain focused on creating a permanent, sustainable advantage by lowering nonfuel unit costs and increasing the fuel efficiency of our fleet.

Fourth-quarter ex-fuel unit costs declined by another 1.3%, bringing full-year nonfuel unit costs down 0.8%. 2015 marks the sixth year in a row of nonfuel unit cost reduction and the 13th year out of the last 14 for the main line. Looking ahead into 2016, we expect nonfuel unit costs to be down 1% on the 8% ASM growth, consistent with our investor day guidance.

I might offer some thoughts on that track record. Every year now for 14 years we've been chipping away at unit costs, and while each year -- each individual year like 0.5% or 1.5% of cost reduction doesn't sound like a lot, the cumulative impact is enormous. Especially when the competition has unit costs that are growing, albeit slowly.

Because of that focus on productivity, our emphasis on low overhead, and a general culture of frugality that's growing throughout Air Group, our cost structure today looks a lot like a low-cost carriers and is nearly 25% lower than the legacy carriers. And if you include fuel and nonoperating expenses, our cost gap widens to 36%. To borrow Brad's phrase that he used at investor day, our economic moat is getting wider and it gives us confidence about the sustainability of our results.

As I mentioned, we remain focused on having one of the most fuel-efficient fleets in the industry. In 2015, our fuel efficiency on an ASM per gallon basis improved by another 2%, with much of that coming from the delivery during the year of 11 737-900ERs and the installation of split scimitar winglets across the majority of the Boeing fleet. This year's improvement extends the cumulative fuel efficiency improvement over the last 10 years to 24% and the trend should continue in 2016 as we take delivery of 19 new 737-900ERs; phase out 13 older, less efficient, and maintenance-intensive 737-400s; and add longer-stage length regional flying.

Speaking of regional flying, Andrew mentioned the profitable growth opportunities we see with large regional jets. In order to fund that growth and replace 15 Q400s that are scheduled for lease return in 2018, we're in the final phase of a regional jet campaign. It is likely that we will place an order for 30 large regional jets in the first quarter of 2016, with deliveries starting in 2017 if we can reach acceptable commercial terms with the parties involved.

Our intent is for those jets to be flown by Horizon if our pilots and flight attendants approve changes to their collective-bargaining agreements that will make them cost competitive with other CPA providers. Voting is taking place now.

SkyWest does a great job operating regional jets for us today and they will continue to operate them in our network despite us potentially bringing some of that jet flying back in-house.

Alaska ended the year with $1.3 billion in cash. Operating cash flow increased by 54% to almost $1.6 billion. 2015 marks the second year in a row of operating cash flow in excess of $1 billion. CapEx was just under $800 million, resulting in free cash flow of almost $800 million.

We used that considerable free cash flow to buy back 7.2 million shares of our common stock or about 5.5% of the shares outstanding. It's noteworthy that going back to 2007 we've bought back 35% of the Company.

In addition, we have paid $102 million in dividends, bringing total return to shareholders to $607 million. Our announcement today that we are increasing our dividends by 38% reaffirms our Board's confidence in the sustainability of our cash flows, is consistent with our goal of creating a track record of dividend increases like other high-quality industrial companies, and makes Alaska the highest yielding stock among US airlines that pay a regular dividend.

Normal principal payments of $116 million brought our long-term debt balance to $686 million. We are now in a $300 million net cash position, even after including operating leases. Alaska's adjusted debt-to-cap ratio stands at 27%. This compares with the median S&P 500 debt-to-cap ratio of 45%.

We have 78 unencumbered mainline aircraft and 86 unencumbered aircraft overall. Our pensions are 92% funded on a GAAP basis and we have no required contributions again in 2016. Alaska remains one of only two US airlines to have an investment grade balance sheet. And of course, in a rising interest rate environment, our low debt levels will further widen our cost gap versus competitors who are more highly leveraged.

We expect to generate very strong cash flow again in 2016. We currently project CapEx to be $705 million next year, including options, but excluding CapEx associated with the regional jet order which could add up to $90 million next year, bringing the total close to $800 million. Using consensus estimates, that would imply free cash flow of nearly $650 million and free cash flow yield of over 7%.

We still expect to return more capital to owners in 2016 than we did in 2015, both through our higher dividend and through share buybacks. We have $880 million remaining on our $1 billion repurchase authorization.

As we enter 2016, our business is working well. We are safe. We run the most reliable operation in the business. We're delivering award-winning service. Customer preference has never been higher. Our labor relations are excellent and contracts have an average length of just under three years.

Our costs are low and they are getting lower. Our investment grade balance sheet is getting stronger. Our new cash flow streams are earnings accretive. We are returning record amounts of cash to our shareholders.

And, more importantly, and most importantly, our people are engaged and we're confident in their ability to continue to do great things in 2016. And with that I would like to open it up to questions that you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Savi Syth, Raymond James.

Savi Syth - *Raymond James & Associates - Analyst*

Good morning, everyone. On the regional jet strategy here, I wonder if you could just elaborate a little bit more about --. I know that the E175 success you've had, but I think the Q400s also served a purpose along the West Coast and maybe even in Alaska. Just wondering what the thinking behind taking down that fleet was.

And if you don't get the pilot deal, would you reverse that thinking or pilot and flight attendant deal? Or would you go forward with it just maybe with a third-party carrier?

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Savi, it's Brandon; good morning. Maybe I will start and Andrew can jump in.

As we think about the regional jets, the opportunity here is as follows. One is they have increased reach versus the Q400. It delivers a better passenger experience, especially on those longer stage length missions than the Q400. Our competition, frankly, is using those in many of our markets and I think we want to make sure that we are staying on par or better with the customer experience side.

We have a much higher revenue opportunity with a three-class cabin and actually, in excess of 400 miles, the regional jet has a lower trip cost. The Q400 has been a great airplane for us and it works well in the short stage lengths around the Pacific Northwest, but I think there's an opportunity to tap into lots of new revenue opportunities with the regional jet by bringing some of those in-house.

Operator

Rajeev Lalwani, Morgan Stanley.

Rajeev Lalwani - *Morgan Stanley - Analyst*

Gentlemen, thanks for your time. Just a question on competitive capacity. It seems like it continues to grow as we look at the next couple of quarters.

Can you just talk about why that is? And just in particular it seems like there are gate constraints at the Seattle Airport, which could tell us that there shouldn't be growth, but it seems like there is. I'd just like to understand that dynamic a bit better, if that makes sense.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Rajeev, it's Andrew. As we've shared, competitive capacity is up 13% for the next few quarters. A lot of this is annualization of competitive capacity that was already announced in 2015 and started in 2015.

As we have been talking, this is something that we've spent a lot of time preparing for and equipping ourselves for with our low-cost strong customer base. So we very much have this in our sites.

As it relates to SeaTac, I think it's one -- you're right; it's getting a little fuller, certainly at the peak times. And it's one, if you want to fly at certain peak times, there's trade-offs to be made. In some of the lull periods there's still space.

But overall we think that we still have a lot of good opportunity at SeaTac as we continue to grow our network and mature our new markets.

Rajeev Lalwani - *Morgan Stanley - Analyst*

Okay. But, Andrew, in terms of competitive capacity, is most of it just lapping? It seems like we've been hearing of announcements for folks like a Spirit and American. I guess I'm just wondering if it's more than just a lapping dynamic.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

No, there is some new -- you're obviously aware of the major reasons of the growth, but as we look at the Q1 and Q2, of the 13% in the second quarter about 2.5 points of that 13% is actually ULCC growth. And we have also seen some Southwest growth as well. So there is some new growth in those figures, for sure, as we move forward.

Lavanya Sareen - *Alaska Air Group, Inc. - Managing Director, IR*

Rajeev, this is Lavanya. Just to keep in mind, ULCC has added four flights on top of our 900 daily flights. Some of it gets exacerbated because of the weighting that we use and we've spoken to you guys about in the past.

Rajeev Lalwani - *Morgan Stanley - Analyst*

Great, thank you.

Operator

Julie Yates, Credit Suisse.

Julie Yates - *Credit Suisse - Analyst*

Good morning, thanks for taking the question. Andrew, I appreciate the reiteration of the capacity guidance for 2016, but thinking about how 2015 trended, I think you ended up about 250 bps higher than your original guidance. Q1 is about 50 bps higher than where you were in October.

How are you thinking about incremental capacity growth in 2016 with crude sub $30 and competitors continuing to aggressively enter Alaska markets?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Thanks, Julie. I'm not -- it's a good question. I knew I was going to be held accountable for my 8% guidance growing pretty large. That's actually why I have reiterated.

I think what I would share with you is in 2015 -- and I think we've been transparent here -- is that part of that was bringing forward some of the growth to continue to grow Seattle at a higher rate than we initially planned to do. But as we move into 2016 -- and, yes, we are a little higher in the first quarter -- we're getting a lot of deliveries this year.

We're getting 19 ERs. They are heavily loaded to the front end, and we don't start pushing out our 400s till the middle of the year and there's 13 of those. So we are a little higher in the first half of the year than we would like to, but as we move into the back part of the year I think we're going to be around 5% or so.

The other thing is we have a lot of mod lines going now putting ATG-4 Wi-Fi on as well as mods for premium economy. So we are going to be using a lot of those aircraft to get all of that done by the end of the year. So I feel fairly confident about where we sit today with our capacity guidance.

Julie Yates - *Credit Suisse - Analyst*

Is there flexibility to delay the retirements on the -400s or even accelerate deliveries if you wanted to? Or is there room still in utilization if you wanted to push the growth above 8%?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

The Chief Operating Officer is looking at me right now and if I was to extend the 400s I may lose some body parts. So the reality is the 400s are going; we really those to leave because of training and all sorts of other things. New deliveries are all fixed.

I think the opportunity for us is if we wanted to grow more, we certainly have utilization play. And certainly, if we want to reduce capacity, we can do that by getting things through the mod lines. At the end of the day, we're going to do what's best for Air Group and we do have that flexibility.

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

Julie, this is Brad. I might just sort of add on. The calculus is sort of risk/return. As you guys have seen, we have had tremendous success putting this new capacity in the markets; the returns have been there.

Most of the markets we added in 2015 were profitable in the first three months, but there is risk to growing at a higher level over a sustained period of time. There's risk and so we're sitting here trying to balance our presence in Seattle, which is an incredible economic engine for the Company, taking advantage of market opportunities while sort of measuring risk.

I think today we want to reiterate that our long-term mindset is 4% to 8% growth. When we see more opportunities we will be at the higher end of that, but that is our mindset and that's what we want you to know.

Julie Yates - *Credit Suisse - Analyst*

Okay, very helpful. Then maybe just one last one for Andrew. How should we think about the impacts from Easter to Q1 unit revenues just conceptually? How would that typically impact your network?

Shane Tackett - *Alaska Air Group, Inc. - VP, Revenue Management*

So I might -- this is Shane Tackett with Revenue Management. It's not a ton. There is obviously the shift; I think we're calling it about 1 point to 1.5 points coming out of April and going into March.

Julie Yates - *Credit Suisse - Analyst*

Okay. That's for the quarter or that's for the month?

Shane Tackett - *Alaska Air Group, Inc. - VP, Revenue Management*

It would be between the two months.

Julie Yates - *Credit Suisse - Analyst*

Okay. All right, great. Thank you.

Operator

Hunter Keay, Wolfe Research.

Hunter Keay - *Wolfe Research - Analyst*

Good morning. Brandon, you sound very fired up and passionate in your prepared remarks, like more than usual. I'm wondering if that is sort of because you are displeased with the stock performance this year.

The question that I have is: how do you think about the buyback? One of the things you guys have done better in the last couple years is being a little more opportunistic about the timing of when you buy on pullbacks. But do you think about ramping it up significantly when it pulls back like this, if you are not blacked out tomorrow?

Not just because you get the chance to buy it cheaper, but because you get a chance to sort of send the message that if this happens again and if you're stock goes down like it has gone down as much as it has lately, that you will be there to take advantage of it and to support it. Do you think about that?

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Good morning, Hunter. It's Brandon. I had a triple latte on the way to work today; that's why I'm fired up. And I do have a high degree of anxiety about the decline of the stock price since the start of the year. But in terms of execution, Mark is the guy to talk about that.

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

Hunter, it's Mark Eliasen. We are opportunistic and we also are programmatic with our stock buyback. We do buy more shares when it's down, and you've seen our behavior in the past. I can't comment on specific actions we might take, but we are aware of where the stock is trading and we do aggressively buy the stock.

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

The algebra of buying back the stock at lower prices rather than higher prices is very good for the owners of this business.

Hunter Keay - *Wolfe Research - Analyst*

Then, Andrew, one of the big topics of over the last six to nine months has been this concept of customer segmentation. It's really only something that has really been talked about in the context of the legacy guys competing against ULCCs as the goal is to sort of prevent business travelers from buying fares that are designed to sell to leisure travelers.

You guys highlighted today that you have about a third of your passengers coming from business travel. Is there a level of self-cannibalization that you are not happy about right now as it relates to sort of how you manage that? And, if so, are there any sort of IT-based projects underway -- IT-based I'm saying, not seat reconfiguration -- underway to sort of address it, particularly as you see ULCC growth ramp in your markets?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Hunter, I think I'm going to have Shane Tackett, VP of RM, answer that question. He has been spending a lot of time on that subject.

Shane Tackett - *Alaska Air Group, Inc. - VP, Revenue Management*

Hunter, I hope I answer the right question. We have been in a unique position, maybe not strategically, but we have nonetheless to be able to watch how other legacy carriers have handled sort of the segmentation at the lower end of the demand curve. We have been sort of interested to see how that has played out, how they have developed the different fare products, and whether or not we think that we actually need to develop something like that on our own.

If we did feel like we needed to access that part of the demand curve, we could. There's not a lot of IT hurdle in the way. We could develop a product and get it to market pretty quickly.

Our sort of history with this, albeit small, certainly out of Portland where we have faced VLCC competition, is we haven't felt the need to use those types of products. We think our customers not only appreciate the superior product we have, but recognize we have already very low fares. And so our differences in fare price for the leisure-focused traveler that ULCCs are going after is much closer than maybe some of the other carriers have had to experience in their market.

So thus far we haven't had to do it, but we could if we need to.

Hunter Keay - *Wolfe Research - Analyst*

Okay, thank you.

Operator

Michael Linenberg, Deutsche Bank.

Michael Linenberg - *Deutsche Bank - Analyst*

I guess couple questions here. I just want to go back to your competitive capacity; I think you said 13% March quarter, 12% June quarter.

Does that -- and I realize -- I'm not sure if this is in the number or not, but American put out some new markets yesterday and it looks like things like LA-Anchorage, LA-Portland, LA-Seattle. Is that in that number?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

No, it is not. I understand that will be starting maybe in June so that wouldn't need to be added to our number.

Michael Linenberg - *Deutsche Bank - Analyst*

Okay. And then, Andrew, since I have you on, when I think about your relationship and how you are sort of moving away from Delta and moving closer to American, I was actually surprised by the number of frequencies that American is putting in those markets. Those are important markets for you.

When I think about LA-Seattle, LA-Portland, those markets are pretty well served. It just was a bit of a surprise. Any thoughts on that or maybe you can't say anything about that?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

I can't say a whole lot except to say that I read the press like you do and it's very clear to me that what American is doing is continuing to fortify their position in Los Angeles. I think Seattle is probably in the top 10 largest O&Ds on the planet and they've decided to serve that with their own medal. Again, we have code on each other and we are looking at that, but at the end of the day they are doing what I see is in their best interests.

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

I think, Andrew, you are saying this but -- and, Mike, we actually need to think about this more ourselves, but I think what could be happening here is this is more about LA than Seattle. There's a couple of airlines that are going to be fighting for dominance in LAX with the consolidation that has happened in the industry and with what is happening with LA facilities. And that actually may be the story here.

Michael Linenberg - *Deutsche Bank - Analyst*

Okay, that's helpful. Then just lastly, the large regional jets that you are looking at to replace the Q400s, are those large regional jets of a similar size or could we be looking at larger aircraft, 90 seaters, 100 seaters, being flown at Horizon?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

76 seat aircraft.

Michael Linenberg - *Deutsche Bank - Analyst*

Perfect. Thanks, nice quarter.

Operator

Helane Becker, Cowen and Company.

Helane Becker - *Cowen Securities - Analyst*

Thanks very much, operator. Hi, guys; thanks for the time. Have you guys thought about 100-seat aircraft?

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Good morning, Helane; it's Brandon. Actually, we've thought about it but right now we're moving forward with a 76-seat regional jet at Horizon and we're also comfortable with 737s at Alaska. We love the simplicity of that.

We recognize there might be a hole in the market, but we're not doing anything at this point to suggest that we would move forward with 100-seat type aircraft.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Helane, we have a good number of 737-700s which very much fit that gap between the 76 and the 163.

Helane Becker - *Cowen Securities - Analyst*

Then my other question is have you guys tried to quantify what percent of the fuel cost decline you've been able to keep in your pricing?

Lavanya Sareen - *Alaska Air Group, Inc. - Managing Director, IR*

Helane, this is Lavanya. This is obviously rough math of what's coming down to the bottom line, but about two-thirds is what we are bringing to the bottom line.

Helane Becker - *Cowen Securities - Analyst*

Great. I think those where my only two questions, actually.

Operator

Jamie Baker, JPMorgan.

Jamie Baker - *JPMorgan - Analyst*

Good morning, two questions. When we think about the RASM declines at Alaska, they are comparatively unique to those of the industry in that they are mostly representative of the increased competition, as opposed to the elimination of fuel surcharges, a strong dollar, a crappy Brazil, and so forth.

Fuel is obviously a blessing for you here, but if and when fuel escalates, your competitors are actually going to be picking up RASM along the way that you won't, save maybe for budgets improving in the state of Alaska. So I am just wondering if you are content with what appears to be a virtual guarantee of significant margin compression if fuel begins to escalate. And if you are not, does that alter your view on the optimal network construct and/or your opinion on consolidation?

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Jamie, it's Brandon. That's a super complicated question. (multiple speakers) [trouble] following it. We're not that smart out here in the Pacific Northwest.

You know, I guess what I would say is -- and I addressed it a little bit in my prepared remarks, which is we don't have a belief that fuel is going to be $28 a barrel WTI forever. And what I would say is that no public company can report record earnings quarter after quarter after quarter.

The other thing I would say is we are generating really, really, really outstanding returns right now. If fuel goes up, I think it is possible that you could see margins come down.

In terms of the broader strategy, what we're -- it goes back to something maybe that Brad said, which is we're going to do the right thing for Alaska. We do have a profit hurdle internally. Most of our markets are well above that; most of our markets would be well above that a $3 fuel. And so we're going to continue to -- we are very satisfied with the networking and we're going to continue to do what's right.

If fuel prices go up, we may adjust capacity, but again we have a view on what our network should look like because we have internal profit targets that those routes need to meet.

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

(multiple speakers) I was going to add that I think the industry today is different than where it was six or eight or 10 years ago. These airlines are run by business people. People want to have earnings. They want to have returns on capital.

I think that if fuel prices go up, as they did four or five years ago, I think you will see people adjust capacity throughout the industry. And that makes us optimistic.

Again, I think our -- to get to your point about margin compression, Alaska's financial performance comes from our competitive advantage. It doesn't come from international exchange rate or Brazilian currency or anything. It comes from us having a cost structure that is 36% lower than the other guy's when you factor in fuel and interest costs.

It comes from the fact that customers prefer to fly with us. We have incredible loyalty in Seattle. It comes from a very strong balance sheet, the right fleet. So I sort of think -- whatever, the world is going to move; what we get thrown our way is going to change from time to time, but I personally think this company has pretty strong competitive advantage that is going to serve us well no matter what environment we're competing in.

Jamie Baker - *JPMorgan - Analyst*

Those are all helpful observations. Second question, if you did want to lock in the forward curve or something shaped similar to where the forward curve is today say for the next 12 months, what sort of premium do you think you would have to pay? In other words, how much would oil have to move against you before a big hedging bet became profitable?

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

Jamie, this is Mark. First of all, I don't think you would see us taking a big hedging bet there. We like the way we're working right now.

The forward curve is nice and low. It's something like $50 a barrel or below that looking out for a long time. So we could do something like, but we kind of like our program the way it's working right now.

Jamie Baker - *JPMorgan - Analyst*

Oh, no; I wasn't suggesting that you should or you need to. I am just kind of -- I'm just trying to gather some information on where hedged premiums might be right now, because it feels like if you did or if anybody did, it would be less hedge and more of just a sheer bet that oil prices would be moving higher. I was just trying to quantify the expense.

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

That's exactly it. It's about $3 a barrel is what we're paying right now for hedging.

One thing back to your earlier question, Jamie, I just wanted [to mention then] (multiple speakers) about what we're doing and what happens if fuel goes up is, as you know, we are retiring all of our 737-400 Classics and those burn about 935 gallons in our. We're replacing those with 900ERs and those burn about 910 gallons an hour. So you can see we are getting more fuel efficient as we get rid of those aircraft.

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

And adding -- (multiple speakers) going from 144 to 181 seats.

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

That's right. And it adds 37 more seats so that's a huge plus, lower fuel burn with more seats. So that helps us over the long run as well.

Lavanya Sareen - *Alaska Air Group, Inc. - Managing Director, IR*

Jamie, not to pile on here, but just to throw another stat out here: in a rising fuel environment, we are 25% more efficient than the industry. That helps us. And, two, if you go back to 2009 we had eight aircraft that were unencumbered. If fuel spikes up or the economy turns, which some people suspect it might, we've got today 86 aircraft that are unencumbered and we'll be well positioned for that.

Jamie Baker - *JPMorgan - Analyst*

I appreciate everybody piling on. I'm off to get my own triple latte. Thank you.

Operator

Darryl Genovesi, UBS.

Darryl Genovesi - *UBS Securities - Analyst*

Thanks for the time. Brandon, at the investor day you alluded to the possibility of being a net borrower this year in order to fund the buyback. With the stock market turmoil and concerns about global growth, granted it doesn't seem like we're seeing any major affect at the US airlines yet, but have you -- I guess are you still thinking about your leverage in the same way as maybe you were at the investor day?

I realize it's very low to begin with, but just wondering if you are still thinking about potentially being a net borrower.

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Good morning, Darryl. Yes, I think we are. I think that our balance sheet is -- I would call it a fortress balance sheet right now. Our debt to cap is low. If there is a recession, there is no better positioned airline than Alaska.

But the amount that we were talking about borrowing, I think at the investor day we put up on the slide maybe $100 million to $200 million, that's pretty small in the grand scheme of things. It certainly does not put the Company at any more risk, recession or not. So we are very open to continuing to look at borrowing to manage the capital structure and would likely do so in 2016.

Darryl Genovesi - *UBS Securities - Analyst*

Okay, thanks for that. Then on CapEx, it looked like from your [investment rep] that you split some deposits forward in the fourth quarter. We've actually seen that at another airline this quarter as well. Just wondering what's driving that and if you are getting better pricing as a result of making the deposits earlier.

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

Darryl, this is Mark. I will just say that we did do that. It was a favor to one of our manufacturers and it does help us out. Favors go back and forth; we have a great partnership with both of our manufacturers and we do that from time to time.

Darryl Genovesi - *UBS Securities - Analyst*

Okay, thanks very much.

Operator

Duane Pfennigwerth, Evercore ISI.

Duane Pfennigwerth - *Evercore ISI - Analyst*

Thanks, good morning. I wonder can you just talk about demand in the state of Alaska, if there's been any change there? I don't know to what extent it's a source of corporate bookings for you. And obviously, there is this annual dividend. We get questions on that from time to time. Is there any change in demand trends given the decline in energy prices here?

Joe Sprague - *Alaska Air Group, Inc. - SVP, Communications and External Affairs*

Duane, this is Joe Sprague. Since I just got back from Juneau late last night, people are pointing at me to take this one, so I will give it a shot. I know there's some question about oil activity, oil business-related activity in the state of Alaska. And I think the first thing I would just say is that despite Alaska, the state being known for its oil reserves and its oil production, our exposure on that front is actually relatively small.

We get business, oil-related business obviously flying our scheduled flight up to Prudhoe Bay, and then we get additional oil-related business because there's so many of the oilfield workers that actually live outside of Alaska and commute to work. So we do get revenue from that activity. I would say it's fairly stable. A lot of the oilfield production workers, although production is declining, those oilfields still require the same amount of workers to sort of operate the drills and the pipelines and so forth, and so it's actually very stable business.

I think we probably will see a bit of a reduction in the exploration for new oil deposits, but that's a much smaller portion of our overall oil portfolio. So bottom line is I think that our exposure on the oil side is minimal and stable.

Beyond that, obviously the state is having some issues because of the fact that they get most of the state revenue from oil reserves, oil royalties and so forth. And so there is a lot of question about this permanent fund dividend check that all of the state residents receive. However, that is tied more to overall market performance at this point than it is to oil prices.

So ironically in 2015, the PMD check that all residents received was over $2000, and that was actually up from 2014. So some of the proposals floating around in the legislature might take that number down. It won't eliminate it by any means. And I think as you look at some of the other factors for travel in the state of Alaska, a lot of the intra-Alaska travel by residence is nondiscretionary because they just -- they have to go. There's no roads in a lot of cases.

And then another big driver over the course of the year for travel in the state of Alaska is tourism, which is actually up. They had their best year ever in 2015 and they are expecting another good year in 2016. So all-in-all I think we could see stable demand in the state of Alaska.

Duane Pfennigwerth - *Evercore ISI - Analyst*

All right, that's great. That's helpful color. Just a brand question. Given your excellent product, service, and reliability, how do you think about balancing that perception for customers that end up on segments operated by your partners?

Let's say just a hypothetical example: a customer books an Alaska flight that is actually an American code share, which is actually operating on an RJ by Mesa. Purely hypothetical, how do you think about managing that customer experience?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

This is Andrew. I think the good news is that as we have continued to grow, and I think I have shared in the past, just a massive amount of passengers are actually traveling on our own new, expanded network. Most of that experience you are referring to is going behind big partners' hubs. We try to be very clear on our confirmation records and everything else who they will be flying and what they will be flying.

But from all the surveys and everything we receive, we don't see any indication that instances like that have any real impact on our customers.

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

Duane, this is Ben Minicucci. We do a lot of business with SkyWest regional jets. I have folks today with SkyWest reviewing their performance on a quarterly basis. So whether it's safety performance, operational performance, customer satisfaction performance, we hold our CPA carriers to a very high standard, the same high standard as Alaska.

Duane Pfennigwerth - *Evercore ISI - Analyst*

Okay, guys. Thank you.

Operator

Andrew Didora, Bank of America.

Andrew Didora - *BofA Merrill Lynch - Analyst*

Great. Good morning, everyone, and thanks for the question here. I guess a follow-up to Andrew just on the competitive capacity here.

Certainly appreciate the update. It seems like the 2Q numbers moving to up 12% from I think it was up 8% as of last quarter is largely coming from the Spirit and Southwest routes that were announced.

I guess, one, do you have an initial read on 3Q competitive capacity? And then, two, with the ULCCs growing more, how do you think about the impact to pricing in your markets, if any? What do you plan to do to adjust to these new entrants? Thanks.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

I will take the first part and I will hand Shane the second. Q3 right now, if you just run the numbers, recognizing there's still industry changes, it's about up 13% again. So I'm not personally expecting competitive capacity to abate anytime soon.

But also, as I shared earlier, as we implement new initiatives as well as dial back our own growth in the back half of the year, I feel very good about where we sit. Shane, on the pricing?

Shane Tackett - *Alaska Air Group, Inc. - VP, Revenue Management*

Yes, on pricing, and I'll just reiterate we I said earlier, we haven't in the past really felt the need to match sort of the published structured price points that ULCCs have brought and we still perform very well. If you actually look at some of the markets out of Portland, we will typically in a market operate more seats than the ULCCs do and outperform on both load factor and yield and have done so over a series of quarters. So I think our product has held up very well; our loyalty has held up very well.

We have incredible point-of-sale strength out of Seattle. I don't really think that that part of the market, the Seattle part of the market, is where they're focused on, so we've seen stability in the structured price environment, even as they have come in. And that is sort of what we anticipate. If something changes, we will obviously react to it and defend our market share if we need to.

Andrew Didora - *BofA Merrill Lynch - Analyst*

Great, thank you. Then one follow-up for Andrew. I think on the last call you said your forward load factors for November and December were flat to slightly up, but I guess the realized loads were down about a point in those months. Was that something you were anticipating or what changed over the course of the quarter that caused that to decelerate a bit?

Shane Tackett - *Alaska Air Group, Inc. - VP, Revenue Management*

This is Shane again. I know we issue, at times, where we actually are. I don't know that we actually give sort of end-of-period guidance, so I think the numbers that we've shared are just where we are right now.

Anytime we grow capacity at a sizable rate we're always looking to book ahead of the booking curve last year. Sort of get out in front of it, get as much leisure traffic as we can. We don't see the same sort of elasticity for the close-in traffic. It's more stable.

We know that it's not going to grow at the same rate as capacity does, so we totally anticipate that those early load factor gaps would decline towards sort of flattish performance year over year. And that's typically what our goal is to keep flat load factor performance year over year. Sometimes we hit; we often do. Sometimes we are a little bit shy of it.

Andrew Didora - *BofA Merrill Lynch - Analyst*

Okay, fair enough. Thank you.

Operator

[David Simpson], Barclays.

David Simpson - *Barclays Capital - Analyst*

Good morning, everyone. A question on that third of your volume that is corporate, particularly technology travel. I would think you guys would overweight technology travel versus the industry.

I'm just curious if you are getting any sense of fear or concern that maybe some of the weakness in energy and industrial travel in the economy may be feeding into technology. Just anything you are hearing there.

Joe Sprague - *Alaska Air Group, Inc. - SVP, Communications and External Affairs*

David, this is Joe again. Nothing too specific there.

I have already sort of covered our exposure on the energy stuff is largely tied to the state of Alaska, so you've got the background on that. Certainly here in Seattle, where we have, far and away, our greatest utility for corporate travelers, we have the benefit of a lot of technology companies here in Seattle and they are traveling a lot. They are doing quite well and we're seeing good strength on that front.

David Simpson - *Barclays Capital - Analyst*

So you are not hearing anything out of travel managers that would make you nervous that this malaise may spread?

Joe Sprague - *Alaska Air Group, Inc. - SVP, Communications and External Affairs*

Not at this time, David.

David Simpson - *Barclays Capital - Analyst*

Okay. And then just a quick one on the credit card spend, the $60 million for the year. Does that phase in fairly evenly through the year or is there a ramp up we should be thinking through the quarters?

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

David, it's Brandon. The cash starts immediately and there's no phase up on the cash, but as you get into the revenue recognition, there may be a little bit of a lag that comes with that.

Operator

Dan McKenzie, Buckingham Research.

Dan McKenzie - *Buckingham Research Group - Analyst*

Good morning. Thanks, guys. Two quick housecleaning questions here. Will Alaska code share with American on their newly-announced capacity adds? Then, secondly, the plan to borrow in 2016, Brandon, what is the new optimal leverage target that you want to get to?

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Dan, I won't be able to comment on that first question.

Brandon Pedersen - *Alaska Air Group, Inc. - EVP, Finance & CFO*

Dan, Mark will take the second question.

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

Dan, I will just tell you that we don't have an exact number. What we know is that high-quality industrials do have more leverage than we do. They are in the 40% to 45% range. As you know, we are down at 27%.

So we don't have a target. We know that we've got some room to grow there and we will be borrowing in the next couple of years.

Dan McKenzie - *Buckingham Research Group - Analyst*

I see. Then, Andrew, I appreciate the commentary around competitive capacity, but as I look at the schedules data it doesn't look like Delta is impacting any new revenue streams sequentially in the first quarter. As I look at the DOT data here, I believe Delta impacted about 69% of Alaska's local revenue at Seattle in the fourth quarter and it's that same 69% that is really affected in the first quarter. And if we move to second quarter it looks like it might tick up to 71%.

So if we are trying to really isolate the incremental revenue headwinds from Delta, it seems like the damage has mostly been done. But, first, is my analysis close or correct? And then, secondly, what do we really need to keep in mind? Because the competitive growth -- the growth in competitive capacity sounds a lot worse than what it might actually be as I look at the underlying data.

Andrew Harrison - *Alaska Air Group, Inc. - EVP & Chief Commercial Officer*

Dan, your analysis is spot on. Essentially really for the first three quarters it was 100% associated with one carrier, but as we move forward you have some Southwest and some ULCCs. The other thing that we are see a little bit too is that the big network guys have been adding to their hubs, which we fly to many of the hubs. So that's the other piece that's replacing the decline in Delta's impact.

Operator

Savi Syth, Raymond James.

Savi Syth - *Raymond James & Associates - Analyst*

Thanks for the follow-up. Just a quick question on Seattle. I know it's been talked about and you mentioned the tightness in capacity availability, especially in the peak times. How do you manage your growth around that tight capacity?

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

Savi, it's Ben. I think the first thing to do is, between Andrew's group and mine, we just work really closely in Seattle and what we do is we just model every time of day. Not only our schedule, but all the other airlines' schedule, and we map out by hour, by 15-minute increments how we can best manage the schedule and if we move things around by 10 minutes or so. That's kind of how we do it.

We have all the departures, all the arrivals and we model it out and then we figure out the best schedule to fit -- to fit, to optimize our network.

Operator

I would now like to turn the call over to Brad Tilden for any closing comments.

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

Thanks, everybody. Appreciate your interest. We look forward to talking with you next quarter.

Operator

Thank you for participating in today's conference call. This call will be available for future playback at www.AlaskaAir.com. You may now disconnect.