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ALK - Alaska Air Group Inc Annual Shareholders Meeting

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CONFERENCE CALL PARTICIPANTS

John Chevedden

PRESENTATION

Operator

Good afternoon, everyone, and welcome to the Alaska Air Group Inc.'s Annual Meeting of Stockholders.

I would now like to turn the conference call over to Mr. Brad Tilden, CEO. Sir, please go ahead.

Bradley D. Tilden *- Alaska Air Group, Inc. - Chairman, CEO & President*

Thank you. And again, good afternoon, everybody, and welcome to Alaska Air Group's 2019 Annual Stockholders' Meeting. My name is Brad Tilden, and I want to thank you all for joining us today.

This is the fourth year we've held our annual meeting in a virtual format. We believe this approach enables a greater number of stockholders to attend the meeting and uses company resources more efficiently, which we believe is in all of our best interests. We believe in transparency and we purposely take steps to make sure the virtual meeting experience replicates an in-person meeting as closely as possible. Those steps are outlined in more detail in our proxy statement.

Each year the Board considers whether to hold the annual meeting virtually or in person and makes a decision that they believe is in the best interest of the company and its stockholders as a whole. We appreciate your participation today.

After a few introductions, we'll conduct our formal business. Then we'll provide an update on our performance in 2018 and describe some of the things we're working on to position Alaska for continued growth and success. And following the business overview, we've set aside time to answer questions that are of interest to investors.

If you are a stockholder and wish to ask a question, you can submit your questions at any time on the virtual meeting website or ask your question during the Q&A session by calling the phone number provided at proxyvote.com. We will address as many questions as possible during the webcast. If we don't get to your question, please send it to the e-mail address listed in the notice of annual meeting and proxy statement. And we'll post a full list of questions and answers on our Investor Relations page at alaskaair.com following today's meeting.

This year, there are 11 director nominees and each has agreed to serve a 1-year term. All are present for today's meeting, and their bios appear in the proxy statement. In addition to myself, the nominees standing for election are: Patty Bedient, who's been an Air Group Director since 2004. She serves as the Board's Lead Independent Director and also serves on the Audit and the Governance and Nominating Committees. James Beer, who joined the Board in 2017. He serves on the Safety and the Compensation and Leadership Development Committees. Marion Blakey, who's been a Director since 2010 and who Chairs the Compensation and Leadership Development Committee and who also serves on the Safety Committee. Phyllis Campbell has been a Director since 2002. She serves as Chair of the Board's Governance and Nominating Committee. Ray Conner, who joined the Board in 2018 and who serves on the Safety and the Compensation and Leadership Development Committees. Dhiren Fonseca, who's been on the Board since 2014 and who serves on the Audit Committee. Susan Li, who joined the Board in 2018 and serves on the Audit Committee. Helvi Sandvik, who served on the Board since 2013 and who is Chair of the Safety Committee. Ken Thompson has been a board member since 1999. He serves on the Board's Compensation and Leadership Development and Safety Committees. And finally, Eric Yeaman, who's been a Board member since 2012. He Chairs the Board's Audit Committee and also serves on the Governance and Nominating Committee.

Serving as a director of Alaska Air Group is demanding, and these dedicated folks care about our company and all of the people who depend on us. We are extremely fortunate to have people of this caliber and diversity serving our company.

Shane Philpot and Dominique Barr of KPMG are the company's independent registered public accountants. Ms. Barr and Mr. Philpot are available to respond to any questions you may have for KPMG regarding the company's financial statements.

I will now call the meeting to order. Our General Counsel and Corporate Secretary, Kyle Levine, will take us through the business portion of the meeting and rule on any questions concerning the conduct and order of the meeting.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Thank you, Brad. This year's shareholders have been asked to vote on 6 proposals. All stockholders entitled to vote at this meeting were sent notice. The proxy materials were available online and by hard copy upon request. After a preliminary count, more than 111 million shares or over 90% of the eligible shares are represented, which gives us a quorum. As soon as all the proposals in the proxy statement have been presented, we will take the vote. Stockholders who have already voted by proxy don't need to vote again except to change a vote. Stockholders can vote during the meeting by logging on to proxyvote.com and clicking on the Vote Here icon.

As Brad mentioned, we will address questions of general interest to our stockholders following the vote. But if you have any questions regarding today's proposals, please submit them online now. Today's voting will conclude and the polls will close at 2:30 p.m. Pacific Daylight Time. We will report the preliminary results at the end of today's program.

The first proposal is the election of 11 directors. Brad introduced the nominees whose names and qualifications are set out in the company's proxy statement. Each of the directors elected today will serve a 1-year term ending with the 2020 annual meeting.

The second proposal is an advisory vote regarding the compensation of the company's named executive officers. While this vote is advisory in nature, the Compensation and Leadership Development Committee will take the results into consideration when deciding future executive compensation arrangements.

The third proposal is the ratification of KPMG as the company's independent registered public accountants for 2019.

The fourth proposal is to approve the amendment of the company's employee stock purchase plan.

The fifth item of business is a stockholder proposal submitted by Mr. Steve Nieman concerning disclosure of Alaska Air Group's political spending. The full proposal is set forth in the proxy statement.

And I believe that Mr. John Chevedden is with us today and has agreed to serve as proxy for Mr. Nieman. Moderator, would you please open the line for Mr. Chevedden.

Hello, John, and please go ahead.

John Chevedden

Hello. This is John Chevedden. I have a procedural issue. This meeting is 3 minutes delayed on the computer. There's a 3-minute delay.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Mr. Chevedden, please proceed with Mr. Nieman's proposal.

John Chevedden

Well, you just announced a person who handles procedural issues and that's an issue when there's a 3-minute delay on the Internet. So I want an answer to that.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Mr. Chevedden, that matter of business is not properly before the meeting at this time. Would you like to present Mr. Nieman's proposal?

John Chevedden

Yes, but I'd like to get an answer. This is the political disclosure report sponsored by Steve Nieman, a retired Alaska Air pilot. Shareholders request that the company provide a report disclosing the company's policies and procedures for making contributions to participate in any campaign on behalf of any candidate for public office or influence the general public with respect to an election, and disclosing contributions used in the manner described above, including the identity of the recipient as well as the amount paid to each recipient, the titles of the company employees responsible for the decision-making. The report shall be posted on the company's website within 12 months of the date of the annual meeting.

As a long-term shareholder of Alaska Air, I support transparency and accountability in corporate electoral spending. This includes any activity considered intervention in a political campaign under the Internal Revenue Code, such as direct and indirect contributions to political candidates, parties or organizations and independent expenditures or electioneering contributions on behalf of federal, state or local candidates.

Disclosure is in the best interest of the company and its shareholders. The Supreme Court recognized this in its 2010 Citizens United decision, which said, "Disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages."

Publicly available records show Alaska Air has contributed at least $400,000 in corporate funds since the 2010 election cycle. However, relying on publicly available data does not provide a complete picture of the company's electoral spending. For example, the company's payments to trade associations that may be used for election-related activities are undisclosed and unknown. This proposal asks the company to disclose all of its electoral spending, including payments to trade associations and other tax-exempt organizations, which may be used for electoral purposes. This would bring our company in line with a growing number of leading companies, including UPS, Norfolk Southern and Union Pacific, which present this information on their website.

The company's Board and shareholders need comprehensive disclosure to fully evaluate the use of corporate assets in elections. I urge your support for this critical governance reform. The company has a stupid response to this proposal. The company's says it's a piece of cake for shareholders to individually sharpen their research skills and track down this information. If it's so easy, why can't the company just do it for the shareholders? Then, the company discourages shareholders from researching this topic because of the incredible claim that the more one knows about this topic, the more likely one is to be confused. Therefore, I ask your support for political disclosure report. This will take very little effort on the part of our company.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Thank you, Mr. Chevedden. The company opposes Mr. Nieman's proposal for the reasons set forth in the proxy statement, which we won't repeat here today.

Finally, the sixth item of business is the stockholder proposal submitted by Mr. John Chevedden concerning changes to the company's proxy access bylaw. The full proposal is set forth in the proxy statement and once again, we invite Mr. Chevedden to speak to shareholders directly.

John Chevedden

So I guess I'm again speaking 3 minutes delayed. So this is proposal 6, enhance shareholder proxy access. Shareholders ask the Board of Directors to amend its proxy access bylaw provision and any associated documents include the following change: A shareholder proxy access director candidate shall not need to obtain a specific percentage vote, for instance 25%, in order to qualify as a shareholder proxy access director candidate in any future shareholder meeting. This proposal is important because a shareholder proxy access candidate might not obtain the current 25% vote, and thus unfortunately be disqualified the following year under our current rule, even if he or she is the most qualified candidate to join our Board of Directors. Shareholders may simply believe that at the time of the annual meeting that the company is not ready for a proxy access candidate and hence may not support the candidate simply because the timing is not right.

A year later, a majority of the shareholders might determine that the timing is right and hence they should not be deprived of voting for a highly qualified candidate. It is especially important to improve a shareholder right such as proxy access to make up for a Board of Directors under the leadership of Phyllis Campbell, who chairs the Board's Governance Committee, taking away an important shareholder right, the right to an in-person annual meeting. We did not even have an opportunity to vote on giving up this right. Perhaps this downsizing of shareholder rights is to be expected since Ms. Campbell has 17 years long tenure, and long tenure is the opposite of a shareholder-oriented independence in a director.

Taking away our right to an in-person annual meeting sends a message that management considers in-person contact with shareholders a nuisance. An obligation for management to explain management's successes and failures during the past year before a live audience is a great incentive plan for management. Alaska Air is now depriving its shareholders of the benefit of an important incentive for management. An in-person annual meeting is a motivator for good performance by management and directors. Who wants to stand in front of a live audience and discuss worst on-time performance, large orders for MAX airliners that are grounded and merger pains with Virgin? It's so much easier to explain it to a microphone.

Today, shareholders can vote against the $14 million paycheck of a CEO after he refuses to answer shareholder questions in person and acts like an in-person contact with shareholders is a nuisance. Voting against CEO pay is proposal 2. Please vote to yes to help make up for the loss of an in-person annual meeting, enhance shareholder proxy access proposal 6.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Thank you, sir. The company opposes Mr. Chevedden's proposal for the reasons set forth in the proxy statement, which we won't repeat here today. I'd also underscore Mr. Tilden's comments this morning of the considerations behind going to a virtual shareholder meeting. We do believe this is in all of our best interests and take steps to ensure that the meeting experience replicates an in-person meeting as closely as possible.

We received no questions directly related to the proposals. This does conclude the presentation of matters to be voted on.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Okay. So Kyle, thanks very much. And this is Brad again. And before we move to the business presentation, I might just sort of say for Mr. Chevedden, every leadership team tries to do their best in terms of their use of resources. I will say that we are out and about a lot in our own communities up and down the West Coast, and the financial community with shareholders. We pride ourselves in being in front of people. Our on-time performance is not the worst in the industry. We are happy to talk about our on-time performance, the Boeing 737 MAX, about executive compensation. We do talk about all of those things. And I don't want to be defensive. I just sort of want to say that it is our responsibility to be out there and talk to people. We do try to do our best. And we try to use our time wisely and that's what we're trying to do today. So appreciate your input on those 2 important questions.

So with that, the business portion of our meeting is officially adjourned. At this time, I've asked our President and Chief Operating Officer, Ben Minicucci; our CFO, Brandon Pedersen; our Chief Commercial Officer, Andrew Harrison; our Vice President of People, Andy Schneider; and our Director of Investor Relations, Matt Grady, to join me as we review Alaska's company financial performance as we talk about our strategy for the future. Other officers are also on hand to answer your questions.

Now over to you, Matt.

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

Thanks, Brad. Good afternoon, everyone. Thank you for joining us for our 2019 Annual Stockholders' Meeting. We are going to transition into the management presentation section of the meeting today with some brief required disclosures and then get right into the presentation.

As a reminder, our comments today will include forward-looking statements regarding future performance which may differ materially from our actual results. Information on risk factors that could affect our business can be found in our SEC filings. We will also refer to certain non-GAAP financial measures during today's meeting. A reconciliation between the most directly comparable GAAP and non-GAAP measures can be found in our SEC filings which are accessible through the Investor Relations portion of our website.

And with that out of the way, I will turn the meeting back over to Brad for an update on the business.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Thanks, Matt. So we've got a handful of slides that the leadership team and I would like to take you through. And if we can advance to the forward-looking statements and get to this slide where we talk about balanced long-term orientation. I'll just sort of say, it looks like we're all on the same slide now.

Running our business in a sustainable way is one of the most difficult things to do in the airline industry, and it's one of the things that we are most proud of. When we look back, we want to look back over any number of years and say that this company was good for the communities where we operate and good for our customers by bringing them fantastic service and low fares. We want to be able to look back and say that we were a really good employer. We provided great jobs for our people and that we provided great returns for the owners of the business. It's a difficult thing to do. Over the long term, you work really hard to provide balance. But in the short term, all of those groups are in competition with one another. And one of the leadership team's primary responsibilities is to try to run the company with balance and with an eye towards making the company great over the long term. So that's what we want to actually talk to you about today.

If we advance the slide, we've got some panels here of what I really believe are this company's core competitive advantages. First one is, Alaska Airlines has terrific employees. We have the best employees in the business and they offer the best service in the business. The upper screen, you see it happens to be the J.D. Power award, which we've won 11 years in a row, but we've won a lot of awards. And we're really proud of our people and the fantastic service they provide.

Great service by itself doesn't do it. In this day and age, people want low fares. And Alaska's fares are $35 or $40 per ticket on a one-way basis lower than the big 3 airlines. And that's a really important part of our growth story over the 5-, 10-, 15- and 20-year periods. How do you make the low fares work? You've got to have a low-cost structure. And one of the ways that we achieve low cost is by operational excellence. When you operate well, you can use airplanes efficiently, you use people efficiently, and you use gates, airport resources efficiently. We have a very fuel-efficient fleet. We're proud of our Boeing airplanes. We're proud of all of our airplanes. Most times when we look at this sort of information, we are the industry leader in fuel efficiency, and that's something we're really proud of. We've got an extraordinary Mileage Plan. We talk a lot about generosity. We want to be the most generous in the industry in terms of how many miles we give you for the tickets that you buy and then when you use those miles in terms of the transportation, the award travel that you can translate them into.

And finally, we've got an extremely strong balance sheet. As of the recent quarter end, 47% of our capital structure, and that's factoring in operating leases, was debt. We borrowed $2 billion to buy Virgin America. And at this point in time, more than half of that, more than $1 billion has been paid back. So we're very proud of the strong balance sheet.

Most of all, we're proud of our fantastic employees that help us offer the great service that this company offers.

If we advance the slide, you can start to look at what the company has done over the years. It's sometimes hard to see 1 year at a time what an airline is doing in the marketplace. But this slide shows the company's route network in 2001. And you see it was largely north-south. We flew to 63 destinations, a lot out of Alaska, a lot out of Seattle, but largely a north-south route network. If you look at it today, we advance the slide, it's an extraordinarily strong network with real strength all up and down the West Coast. We have hubs in Anchorage, Seattle, Portland, San Francisco, San Jose, Los Angeles and San Diego. They're powerful hubs. Some of those hubs are working fantastic today. Some of those are hubs that we're working on, but we're extraordinarily bullish and optimistic about what these hubs are going to do for the company in the years ahead.

If we advance the slide one more time, you'll see sort of a summary of the company's financial performance, whether it be pretax margin or free cash flow or return on invested capital or what have you, over the last 7 or 8 or 9 years. We compare ourselves to other airlines. We compare ourselves to high-quality industrials. We realize that our investors, they don't have to choose just between Alaska and another airline. They can choose between Alaska and other good industrial companies. And so we want to compare well against those folks, and we believe that we do.

Advance the slide again, you'll see a summary of our revenue and our adjusted pretax income. What you see is the revenue. The size of the company has increased materially in the last few years. That's a lot of organic growth. And it's also bringing Virgin America into the fold in 2017. And then you see the profit on the right side. What I personally would say about this, and everyone that looks at it probably has their own perspective, but the profit levels in 2015 and 2016 probably were not sustainable levels of profitability. They were extraordinarily good years. But at 9% in 2018, our profit level is lower than we want it to be.

If we advance the slide one more time, you'll see a slide that we laid out for the owners of the company at our Investor Day in New York this past fall, where we laid out our road map to get the profitability of the company back to pretax margins of 13% to 15%. We've got a lot of initiatives that are helping us get there. We're on pace to make great progress in 2019.

And as I turn the call over now to Ben, Ben and the other leaders are going to take you through some of the initiatives that we are going to drive to improve the performance of the company. Over to you, Ben.

Benito Minicucci - *Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc*

Thanks, Brad, and good afternoon, everyone. Over the past 10 to 15 years, there's been massive consolidation in our industry. We often get asked whether we still feel the acquisition of Virgin America was a good idea. And without question, we always say yes. This merger has provided Alaska greater access to large and attractive California markets and capacity-constrained airports such as Los Angeles and San Francisco. The merger also gives us more geographic diversity, which means we have less revenue concentration and reliance on the Pacific Northwest. Today, we have a West Coast network that Brad has shown, that offers significant relevance to our guests and provides the highest seat share of any airline for West Coast travelers.

And with our increased presence in California come significant potential for Alaska to grow. California has almost 4x the population of Washington, Alaska and Oregon combined, with an economic GDP that ranks sixth in the world. All of our relevant brand preference and loyalty has grown a lot over the last 2 years, we are just in the early stages of expanding our loyalty program and bringing our award-winning product and service to California.

From an integration perspective, we are very pleased with our progress and milestone achievements over the last 2.5 years. We've aligned our revenue management functions, integrated all of our payroll and benefits, integrated loyalty programs, co-located airport stations and our system operations. We achieved a single operating certificate from the FAA. We integrated our reservation systems and without a single disruption to our operation. And perhaps, most importantly, today, we have joint collective bargaining agreements, an integrated seniority list with all but one of our unionized work groups. We've completed many aspects of integration faster than any other airline integration before, and we are grateful to all our teams who worked so hard to get this thing done.

Work still remains within our M&E group, our maintenance and engineering group, on integrating process and systems, as well as Airbus interior configurations which should be largely complete this time next year.

The one area that has no end date for completion is culture. We are focused and committed to keeping our culture the cornerstone of our success at Alaska. Over the past 6 months, we've brought in more than 20,000 employees to attend an interactive session with our leadership team called Flight Path. It was conducted in a beautifully branded space designed to bring us together as one team. There were spirited conversations and some tough Q&A throughout these 38 sessions. In the end, despite areas that still need attention and fixing, it was clear to us how much our people love Alaska.

Now to talk more about our culture, I'll hand it over to Andy Schneider.

Andrea L. Schneider - *Alaska Airlines, Inc. - VP of People*

Thank you, Ben, and hello, everyone. Both Brad and Ben spoke about the importance of culture, and we do value culture highly at Alaska. But it's possible for shareholders to wonder how investing in our culture could be good for owners. Well, we want to make that connection very clear for you here today. Fundamentally, our culture drives our performance and our performance drives our financial results. It also gives our employees a sense of belonging and pride in their work, which does lead to our award-winning service and the service that we're known for. And all of this leads to loyal customers. And the more loyal customers you have, frankly, leads to more consistent demand, which ultimately makes us a more profitable airline. Culture really is at the core and the foundation of everything we do to make this airline run, and run well.

Since culture is so important, we continue to invest in it. This is especially important as we completed the bulk of the integration and have begun to execute on a road map as a single team. We want all our employees to identify as Alaska employees, not as legacy this company or legacy another company. As Ben mentioned, 20,000 of our employees participated in an interactive session with management to help us align around our shared history, vision, values and strategies. The time spent was well spent by all. I think all employees and leaders gained appreciation for it. These sessions were led by some of the highest-level leaders of our organization, and they got great enjoyment and satisfaction from interacting with our fine employees in this important time.

And as we continue to invest in culture, our performance will improve. And that's where Shane is going to talk about next.

Shane R. Tackett - *Alaska Air Group, Inc. - Executive VP of Planning & Strategy of Alaska Airlines, Inc.*

Thanks, Andy. Go to the next slide, Matt. Yes, Brad shared this slide laying out our road map to 13% to 15% margin once already, but I want to add for you the specific initiatives we have planned within each of the margin driver categories, which are shown on the right. They are discrete, trackable and have specific dollar targets associated with each of them. And there are actually more than we've shown here. We've already started to make progress against many of these with the increase in bag fees we implemented late last year, the launch of our Saver Fare product in January and the additional cross-fleeting we implemented in mid-March to our New York market.

Our Q1 unit revenues included 300 basis points of incremental revenue from these initiatives alone, and our unit cost outperformed our plan due in part to savings we're finding in our supply chain or vendor management initiative. We're pleased with the early results we're seeing as we begin to execute against the plan laid out here, which puts us on track to driving the company's profitability to target levels.

As mentioned on the last slide, synergy opportunities are a key contributor to our margin road map. These include cross-fleeting, loyalty growth and reconfigurations to the Airbus cabin as primary drivers. Importantly, nearly 80% of our forecasted synergy value from the merger is still to come, and we're starting to capture them in earnest this year. Cross-fleeting, as I mentioned, to New York began in March. Loyalty growth continues to be strong in California and the other parts of the country. And the Airbus mods are underway and we look to be complete, as Ben said, in the first quarter of 2020. As a reminder, the Airbus mods add to the total seat count on our Airbus aircraft and to the total Premium seat count in both the First Class and Premium Class cabins.

We also see $240 million or more in revenue opportunity from initiatives going forward. Saver Fare is the most significant of these at more than $100 million in incremental revenue annually. And so far, it has been ramping up ahead of schedule. Bag fees are in place, and corporate sales and other ancillary initiatives are underway and ramping as planned.

And finally, we see 4 main areas of opportunity on the cost side of the business. The biggest unlock of cost leverage is asset utilization and productivity, largely driven by our schedule. We look to get back to peak productivity within every division of the company or better over the next 2 years, and we believe that will drive at least $75 million in cost savings versus today's run rate.

The next most leveraged area is overhead, which we've already begun to address through zero-based budgeting and a management headcount reduction that we implemented last year. Overhead was reduced some 7% in the first quarter of this year versus the same quarter a year ago.

A third area is aircraft ownership and other costs tied to third-party relationships and contracts. So far this year, the savings from this effort have been tracking nicely above our $20 million initial target.

And finally, we continue to see a nice tailwind within selling expenses as growth in guest loyalty and our credit card program have led to a higher percent of direct bookings and bookings made through our co-brand credit card, which has reduced the amount of commissions and processing fees we pay to third parties.

To summarize, we've identified a number of specific and measurable cost and revenue levers that we're beginning to pull to improve the unit economics of our platform -- as our platform delivers. And as we do this, we're headed back toward our target of 13% to 15% pretax margins.

With that, I am going to turn it over to Andrew.

Andrew R. Harrison - *Alaska Air Group, Inc. - Executive VP & Chief Commercial Officer of Alaska Airlines Inc.*

Thanks, Shane, and good afternoon, everybody. It's been a year of significant expansion. And one of the core pillars and again, 1 in 3, 30% of all tickets purchased are really around price. And one of the things we're really investing in, as Brad mentioned, is low fares. And it's not just the fare you pay, it's what comes with that fare. And we position ourselves in a really good place where we give you a lot of the benefits of the legacy airlines, whether it's lounges, global travel, First Class, Premium Class seating at fares that are very close to low-cost carrier fares. And as Shane mentioned, we also introduced Saver Fares, which again, for the really cost-conscious traveler we can have a really cheap price for you as well.

And as we look to be the West Coast favorite, and that doesn't mean we're going to be the largest West Coast carrier, but we want to be the carrier that is really endeared by our guests, that is reliable and shows up every time for those who fly us. We just talked about low fares and great value. The genuine and caring service, we're going to touch on, but that's core to our DNA, Mileage Plan and of course, the West Coast vibe. One of the things that we've really been excited about and established as we've moved forward here with the acquisition, as you can see there on the right side of the slide, is our awareness. Since closing the deal, we've moved up 12 points. We have a ways to go. But as Ben mentioned, the size and the breadth of California, getting our awareness up is going to be crucial, and we're well on our way to doing that.

We've also taken this opportunity as a result of the acquisition to really revisit our entire product offering. It is a very exciting time for us. And really, 2018 was a big year of decisions and it was a big year of beginning to roll out significant changes across our product. This not only drives guest satisfaction, but also for shareholders, it's going to drive incremental revenue. The Airbuses are all going to be fitted with brand-new interiors with our state-of-the-art interiors, including all new First Class cabins, where we've upped the standard of the product offering we're making. Satellite is going to be across our system, which includes Hawaii. It's going to really change the way that you're able to enjoy onboard product and entertainment as we fly. Our food and beverage program and of course, lounges, which are a huge part for loyalty members. And we're building a 15,000 square foot lounge in Seattle, going to be one in San Francisco next year. We opened one just recently in New York, all of these things to enhance the experience of our guest.

But as we grow California, we have not forgotten about the Pacific Northwest. And I think Paine Field, I think, is the newest commercial airport opened in 50 years in this country. It's only 2 gates, but we're very excited about it. And the reality is, we've got 18 flights a day, which is about 6% of the number of departures in Seattle, wonderfully located north of Seattle for our guests, to 8 destinations. And we've been excited how well this has grown. And our loyalty members especially are really enjoying the convenience of this new airport.

And then, of course, on the loyalty side, not only does the loyalty program drive significant economics to the company and for shareholders, but I think what's really interesting about loyalty is, this is our guests saying we like to be part of your family. When we stay and fly with you, you treat us well. You board us well. You treat us with respect. And the growth in these numbers is a testament to the front line and everything we have been delivering in California and across the Pacific Northwest. You can see there the growth in our Mileage Plan member and credit cards across the United States are very, very large. Pacific Northwest is a very mature base, and you've got big double-digit growth there. And then, of course, in California, these are very, very significant growth rates, 34% for the card, 51% for the Mileage Plan since we came together with Virgin America. And what this says is, is that our guests and the people who fly us in California feel really good about our product and offering and are joining and want to be a part of our loyalty program.

And then, of course, one of the things that, I think, when you really stand back and the most important thing is our guest satisfaction. And we've been through all this integration in airports and policies and procedures and revenue changes, fleet changes and moving aircraft around the systems, employees, all these changes. And even after all of that, we've got the #1 in guest satisfaction by J.D. Power. And we also have got the #1 position for the American Customer Service Institute. We love to get rewards. But really, this is about our guests saying and putting their confidence in us that they think we're doing a good job. And that just drives us to do even a better job.

So as I close, as we move into 2019, we think we have a fantastic foundation to now take this and to grow this for our shareholders, for our guests and for our employees.

And I'll turn it over to Brandon.

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

Thank you, Andrew. Good afternoon, everybody. Alaska has a long track record of profitable growth and 2018 was no different. The business grew at 5.3% on a capacity basis. Total revenues grew by 5% or $370 million to $8.3 billion. We produced a pretax profit of $739 million as you see in the chart that you're looking at, which again is roughly a 9% margin. Heavy competition, much higher fuel prices that we were unable to recover because of that competition and other higher cost increases drove the decline you see in 2018 compared to 2017.

However, our revenue and cost initiatives, along with our slower growth, will drive both higher profit and margin expansion in 2019. In the chart, we've illustrated pretax profit for 2019 based on current First Call consensus estimates of $5.67 per share, which equates to pretax profit of roughly $950 million.

And that margin expansion in 2019 sets the foundation for our longer-term plan to grow margins to 13% to 15% as you've heard today. This goal reflects the reality that a larger portion of our business is in highly competitive markets, our desire to grow with low fares and yet is still consistent with our goal of delivering margins that are higher than the industry average and producing returns on invested capital that are 400 basis points or more above our weighted average cost of capital.

Our near-term path, including targets for merger synergies, revenue initiatives and support functions and operational efficiency gains, are portrayed in the slide, and Shane walked you through those in some more detail.

Our higher profit will produce higher operating cash flows, nearly $1.5 billion this year based on again on consensus estimates. Our fleet growth, which drives most of our capital spending, is modest. And so total CapEx will be roughly $750 million this year, resulting in free cash flow of over $700 million, almost double the $370 million we produced in 2018.

Looking at the CapEx makeup in the chart. You'll notice a larger amount of the light blue or spending on things other than aircraft deliveries, that spend represents 4 very important things that you've heard today: first, the retrofit of the Airbus airplanes; second, installation of satellite across the fleet, the mainline fleet; and third, important investments we're making in culture, including the building that we're building across the street that we're calling The Hub that will house an integrated systems operation control facility, certain IT functions, an important part of our people functions and then other employee common spaces.

Our fleet won't grow much this year, 9 mainline jets, assuming 3 MAX and 4 E175 should come into the fleet this year. And then along with the 32 operated by Skywest under CPA, that should bring the fleet to 334 this year.

The free cash flow that we're producing is allowing us to make great progress deleveraging our already strong balance sheet. In 2018, we reduced balance sheet debt by $470 million, ending the year with adjusted debt to cap of 47%. In 2019, we expect to reduce balance sheet debt further by $350 million with $140 million of that already completed, and end this year with adjusted debt to cap at 43% as illustrated in this chart. We've now retired more than $1 billion of the $2 billion we borrowed to acquire Virgin America, as Brad mentioned.

Other liquidity sources remaining include more than 90 737 and E175 aircraft that are owned free and clear, and more than $400 million of undrawn line of credit capacity.

As we repaid debt, we've also returned capital to you, our owners. In January of 2018, we raised the dividend by 6.6% from $0.30 to $0.32 per share per quarter. The dividend combined with share repurchases made in 2018 resulted in $208 million being distributed in that year. That's the $158 million you see on the chart, plus $50 million of share buybacks. In Q1 of 2019, we raised the dividend again, this time another 9.4% from $0.32 to $0.35 per share per quarter. This was the sixth increase since we initiated it in 2013. Since inception, the dividend has grown 250%. Again, using 2019 consensus estimates and aggregating dividends and expected share buybacks, we should have an aggregate payout ratio in excess of 30% of net income.

Let me close by returning to this model. We're working to create a virtuous cycle where profitable growth is at the center, a model where all of our stakeholders benefit over the long term, including our people, our guests, our communities and you, our owners. We have a plan that we're excited about that should set us up for success for the years to come.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Okay. We now have about 15 minutes for questions from stockholders. If you have a question of general interest, please submit it online or dial the number provided for stockholders at proxyvote.com to ask your question telephonically.

Operator, would you please instruct stockholders how to enter the queue once they've dialed in?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Thank you, operator. While stockholders are entering the queue, I'd like to introduce our Manager of Corporate Communications, Geni Venable, who will help present the questions we receive.

Geni Venable - *Alaska Air Group, Inc. - Manager of Corporate Communication*

Thanks, Kyle. Our first question this afternoon is, does Alaska fly any 737 MAX plane? How many? How will you ensure that these planes are safe before you return them to service?

Benito Minicucci - *Alaska Air Group, Inc. - President & COO of Alaska Airlines Inc and CEO of Virgin America Inc*

Our first MAX would be delivered in June and not being planned in service in July. So at this point, we have no MAXes 3 for the total year. And without question, these airplanes will not re-enter service until the FAA lifts the grounding of the MAXes and we are 100% certain that these aircraft are safe to put back in service.

Geni Venable - *Alaska Air Group, Inc. - Manager of Corporate Communication*

Our next question, how many 737 MAX aircraft are on order and can Alaska cancel some of its 737 MAX orders?

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

This is Brandon Pedersen. We have 34 of the MAX currently on order. As Ben just mentioned, 3 are scheduled to come this year. We placed that order back in October 2012 and we have no plans to cancel that order at this time.

Geni Venable - *Alaska Air Group, Inc. - Manager of Corporate Communication*

Our third question, are there any plans to integrate Virgin America mechanics and AMFA mechanics?

Shane R. Tackett - *Alaska Air Group, Inc. - Executive VP of Planning & Strategy of Alaska Airlines, Inc.*

This is Shane Tackett. And yes, we do intend to integrate the legacy Virgin America mechanics with our Alaska mechanics. We'd like that very much. It's important for our maintenance team to become one group and to our operation. Alaska's premerger mechanics are represented by a union, the Aircraft Mechanics Fraternal Association. And under our contract with AMFA and federal laws that regulate airlines, we can only integrate those workers once AMFA has been recognized as the representative of legacy Virgin America mechanics and once we are provided with an integrated seniority list. To date, AMFA has not filed to represent the legacy Virgin America mechanics and as such we cannot proceed integrating the workforce. We have provided, however, legacy Virgin America mechanics with pay benefits and other work rules comparable to those provided to Alaska mechanics under their contract.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, VP of Legal, General Counsel and Corporate Secretary*

Okay. At this point, we have not received any further questions. So that concludes the Q&A portion of today's meeting. The votes have been tabulated and the preliminary results indicate the following: The 11 directors introduced earlier have each been elected to 1-year terms on the Board, with each director receiving the approval of at least 79% of the shares present.

Proposal 2, the advisory vote on the compensation of the company's named executive officers received the approval of approximately 97% of the shares present and entitled to vote.

Proposal 3, ratification of the company's independent accountants has passed, receiving the approval of approximately 99% of the shares present and entitled to vote.

Proposal 4, approval of the amendment of the company's employee stock purchase plan has passed, receiving the approval of approximately 99% of the shares present and entitled to vote.

Proposal 5, the stockholder proposal concerning disclosure of the company's political spending has failed, receiving the approval of 43% of the shares present and entitled to vote.

And proposal 6, the stockholder proposal to allow for renomination of director candidates submitted via the company's proxy access bylaw regardless of the prior year's support has also failed, receiving the approval of just 31% of the shares present and entitled to vote.

The final voting results will be filed with the SEC on Form 8-K within the next few business days and will be available on our website at alaskaair.com. A recording of this meeting will also be available for replay on our website at alaskaair.com under Investor Relations. Thank you, everyone, for joining us today.

Operator

Ladies and gentlemen, the conference has now concluded. We do thank you for attending today's presentation. You may now disconnect your lines.
