

ALASKA AIR GROUP INC
Form 8-K
May 23, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 8-K

CURRENT REPORT PURSUANT
TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

May 23, 2007

(Date of earliest event reported)

ALASKA AIR GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation)

1-8957
(Commission File Number)

91-1292054
(IRS Employer Identification No.)

19300 International Boulevard, Seattle, Washington
(Address of Principal Executive Offices)

(206) 392-5040

98188
(Zip Code)

(Registrant's Telephone Number, Including Area Code)

(Former Name or Former Address, if Changed Since Last Report)

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Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (*see* General Instruction A.2. below):

- .. Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

 - .. Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

 - .. Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

 - .. Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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References in this report on Form 8-K to Air Group, Company, we, us, and our refer to Alaska Air Group, Inc. and its subsidiaries, unless otherwise specified. Alaska Airlines, Inc. and Horizon Air Industries, Inc. are referred to as Alaska and Horizon, respectively, and together as our airlines.

FORWARD-LOOKING INFORMATION

This report contains forward-looking statements subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These statements relate to future events and involve known and unknown risks and uncertainties that may cause actual outcomes to be materially different from those indicated by any forward-looking statements. Some of the things that could cause our actual results to differ from our expectations are:

the competitive environment and other trends in our industry;

changes in our operating costs, including fuel, which can be volatile;

labor disputes and our ability to attract and retain qualified personnel;

the timing of the disposal of our remaining MD-80 aircraft and the amounts of potential lease termination payments with lessors and sublease payments from sublessees;

our significant indebtedness;

compliance with our financial covenants;

potential downgrades of our credit ratings and the availability of financing;

the implementation of our growth strategy;

our ability to meet our cost reduction goals;

operational disruptions;

general economic conditions, as well as economic conditions in the geographic regions we serve;

the concentration of our revenue from a few key markets;

actual or threatened terrorist attacks; global instability and potential U.S. military actions or activities;

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insurance costs;

changes in laws and regulations;

increases in government fees and taxes;

our inability to achieve or maintain profitability;

fluctuations in our quarterly results;

an aircraft accident or incident;

liability and other claims asserted against us;

our reliance on automated systems; and

our reliance on third-party vendors and partners.

For a discussion of these and other risk factors, see Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2006. All of the forward-looking statements are qualified in their entirety by reference to the risk factors discussed therein. These risk factors may not be exhaustive. We operate in a continually changing business environment, and new risk factors emerge from time to time. Management cannot predict such new risk factors, nor can it assess the impact, if any, of such new risk factors on our business or events described in any forward-looking statements. We expressly disclaim any obligation to publicly update or revise any forward-looking statements after the date of this report to conform them to actual results. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such differences might be significant and materially adverse.

ITEM 7.01. Regulation FD Disclosure

Pursuant to 17 CFR Part 243 (Regulation FD), the Company is submitting information relating to its financial and operational outlook for 2007. This report includes information regarding forecasts of available seat miles (ASMs), cost per available seat mile (CASM) excluding fuel consumption, as well as certain actual results for revenue passenger miles (RPMs), load factor and revenue per available seat mile (RASM), for its subsidiaries Alaska Airlines, Inc. and Horizon Air Industries, Inc. Our disclosure of operating cost per available seat mile, excluding fuel, provides us the ability to measure and monitor our performance without these items. The most directly comparable GAAP measure is total operating expense per available seat mile. However, due to the large fluctuations in fuel prices, we are unable to predict total operating expense for any future period with any degree of certainty. In addition, we believe the disclosure of fuel expense on an economic basis is useful to investors in evaluating our ongoing operational performance. Please see the cautionary statement under Forward-Looking Information.

In accordance with General Instruction B.2 of Form 8-K, the information in this report shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), nor shall such information be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such a filing. This report will not be deemed an admission as to the materiality of any information required to be disclosed solely to satisfy the requirements of Regulation FD.

Air Group Information

Giving consideration to economic fuel costs, unit revenue trends and forecasted non-fuel unit costs, we currently expect our consolidated adjusted net income in the second quarter and full-year 2007 to be below 2006 amounts. However, actual results could differ materially from our current expectation.

Alaska MD-80 Fleet Transition

The Company has reached an agreement with a buyer for its 20 owned MD-80s. As of May 23, 2007, the Company had closed on sale transactions for 16 of these aircraft and expects to complete the remaining sales during the second quarter. The majority of these aircraft will be leased from the buyer under short-term lease arrangements. As a result, our aircraft rent expense will increase.

Alaska Airlines

The information for Alaska below reflects mainline information, which excludes contract flying provided by Horizon and contract flying between Anchorage and Dutch Harbor, AK, provided by a third party. Additionally, as described in previous filings, Alaska reclassified the revenues and costs for prior periods that are associated with the Dutch Harbor flying. As a result of this reclassification, CASM excluding fuel and other noted items for the second quarter of 2006 that was originally reported as 7.92 cents will now be reported as 7.85 cents. Mainline total RASM that was originally reported as 12.18 cents will now be reported as 12.10 cents.

Our forecast for second-quarter mainline unit costs at Alaska is as follows:

Alaska Airlines

| <i>Mainline Statistics</i> | Forecast Q2 2007 | Change Yr/Yr |
|---|-----------------------------|-------------------------|
| Capacity (ASMs in millions) | 6,116 | 5% |
| Fuel gallons (000,000) | 88.3 | (1)% |
| Cost per ASM as reported on a GAAP basis (cents)* | 10.6 | (3)% |
| Less: Fuel cost per ASM (cents)* | 3.1 | 4% |
| Cost per ASM excluding fuel (cents)* | 7.5 | (4)% |

* For Alaska, our forecasts of mainline cost per ASM and fuel cost per ASM are based on forward-looking estimates, which will likely differ from actual results due to several factors including, but not limited to, the volatility of fuel prices. Fuel cost per ASM above includes our estimate of raw fuel cost for the second quarter and the actual adjustments to our fuel-hedging portfolio in April. See page 5 Other Financial Information Calculation of Economic Fuel Cost per Gallon below for additional information regarding fuel costs.

Alaska Mainline Revenue and Traffic

Alaska's April mainline traffic increased 2.0% to 1.515 billion RPMs from 1.486 billion flown a year earlier. Mainline capacity for April was 1.970 billion ASMs, 4.2% higher than the 1.890 billion in April 2006. The mainline passenger load factor (the percentage of available seats occupied by fare-paying passengers) for the month was 76.9%, compared to 78.6% in April 2006. The airline carried 1,447,800 passengers compared to 1,420,300 in April 2006.

In April 2007, our *mainline* passenger RASM declined by 2.8%. The decrease is mainly due to a 1.8-point year-over-year decline in load factor and a 0.7% decline in passenger yield. Year-over-year mainline *total* RASM was down 1.5% in April.

Alaska Regional Flying

As discussed in our Form 10-Q for the quarter ended March 31, 2007, Alaska and Horizon entered into a Capacity Purchase Agreement (CPA) effective January 1, 2007. Prior to 2007, there was a revenue sharing arrangement in place whereby Alaska made a payment to Horizon if certain incentive markets resulted in losses for Horizon. Alternatively, Horizon made a payment to Alaska if those incentive markets were profitable. Although the markets have changed slightly, we believe it is useful to compare the revenue trends of the markets subject to the CPA in 2007 to those covered under the prior incentive market arrangement. Actual Passenger RASM in those markets declined in April due to a 0.5-point decline in load factor and a 5.0% decline in yields. As disclosed in our March 2007 Form 10-Q, we believe Alaska's regional flying costs paid to Horizon will exceed regional flying revenues for those markets in the second quarter, but not to the extent they did in the first quarter of 2007.

Horizon Air

| | Forecast Q2 2007 | Change Yr/Yr |
|---|---------------------|-----------------|
| Capacity (ASMs in millions) | 969 | 8% |
| Fuel gallons (000,000) | 15.6 | 18% |
| Cost per ASM as reported on a GAAP basis (cents)* | 18.9 | 12% |
| Less: Fuel cost per ASM (cents)* | 3.5 | 21% |
| Cost per ASM excluding fuel (cents)* | 15.4 | 10% |

* For Horizon, our forecasts of cost per ASM and fuel cost per ASM are based on forward-looking estimates, which will likely differ significantly from actual results. There are several factors impacting our estimates including, but not limited to, the volatility of fuel prices. Fuel cost per ASM above includes our estimate of raw fuel cost for the second quarter and the actual adjustments to our fuel hedging portfolio in April. See page 5 for additional information regarding fuel costs.

Horizon's cost per ASM includes the expected loss on the sublease of Q200 aircraft to a third party. We expect the loss will be approximately \$1.5 million per aircraft, which will be recorded when the aircraft leave our operating fleet. Currently, we expect to deliver three of the Q200s to the third party during the second quarter. The increase in Horizon's cost per ASM, excluding fuel, over prior forecasts of 14.8 cents is due primarily to higher wages, higher maintenance cost as a result of the timing of certain maintenance events, and a decrease in capacity dedicated to Frontier JetExpress.

Horizon Revenue and Traffic

Horizon's April traffic increased 2.8% to 227.8 million RPMs from 221.6 million flown a year earlier. Capacity during April was 319.0 million ASMs, 8.3% higher than the 294.5 million in April 2006. The passenger load factor for the month was 71.4%, compared to 75.2% in April 2006. The airline carried 587,400 passengers compared to 553,200 in April 2006.

In April 2007, Horizon's total RASM increased 1.6% compared to April 2006.

Horizon's line-of-business information is summarized as follows:

| | % of ASMs |
|--|------------|
| Horizon brand flying | 50 |
| Capacity Purchase Agreement- Alaska | 33 |
| Capacity Purchase Agreement- Frontier JetExpress | 17 |
| Total | 100 |

Horizon brand flying includes those routes in the Horizon system not covered by the Alaska CPA. Horizon has revenue risk in those markets. RASM for brand flying declined 10.2% in April 2007 as a result of a 7.7% decline in yield and a 2.4-point decline in load factor.

Revenue from the Capacity Purchase Agreement with Alaska is eliminated in consolidation. See Alaska *Regional Flying* discussion above.

Other Financial Information

Liquidity and Capital Resources

As of April 30, 2007, Air Group cash and short-term investments totaled approximately \$895 million.

Fuel Hedging

We are providing unaudited information about fuel price movements and the impact of our hedging program on our financial results. Management believes it is useful to compare results between periods on an *economic basis*. Economic fuel expense is defined as the raw or into-plane fuel cost less the cash we receive from hedge counterparties for hedges that settle during the period, offset by the premium expense that we recognize. A reconciliation of *economic fuel expense* to our GAAP *fuel expense* is presented below. GAAP *fuel expense* is defined as the raw fuel cost plus the effect of mark-to-market adjustments that we include in our income statement as the value of our fuel-hedging portfolio increases and decreases. A key difference between GAAP *fuel expense* and *economic fuel expense* is the timing of gain or loss recognition.

Calculation of Economic Fuel Cost Per Gallon

| April 2007 (unaudited) | Alaska Airlines | | Horizon Air | |
|--|------------------|--------------------------|------------------|----------------------|
| | (\$ in millions) | Alaska Airlines Cost/Gal | (\$ in millions) | Horizon Air Cost/Gal |
| Raw or into-plane fuel cost | \$ 60.4 | \$ 2.11 | \$ 11.1 | \$ 2.21 |
| Gains on settled hedges | (1.4) | (0.05) | (0.3) | (0.05) |
| Economic fuel expense | \$ 59.0 | \$ 2.06 | \$ 10.8 | \$ 2.16 |
| Adjustments to reflect timing of gain or loss recognition resulting from mark-to-market accounting | 1.7 | 0.06 | 0.3 | 0.06 |
| GAAP fuel expense | \$ 60.7 | \$ 2.12 | \$ 11.1 | \$ 2.22 |

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The majority of the Company's hedge instruments are call options. Call options are intended to effectively cap our pricing on the crude oil component of fuel prices. With call option contracts, we benefit from the decline in crude oil prices, as there is no downward exposure other than the premiums we pay to enter into the contracts. These premiums are expensed when the contracts settle. Alaska Air Group's future hedge positions are as follows:

| | Approximate % of Expected Fuel Requirements | Approximate Crude Oil Price per Barrel |
|---------------------|--|---|
| Second Quarter 2007 | 53% | \$57.31 |
| Third Quarter 2007 | 49% | \$56.98 |
| Fourth Quarter 2007 | 41% | \$59.67 |
| First Quarter 2008 | 36% | \$61.92 |
| Second Quarter 2008 | 29% | \$63.53 |
| Third Quarter 2008 | 21% | \$63.94 |
| Fourth Quarter 2008 | 23% | \$64.20 |
| First Quarter 2009 | 5% | \$67.68 |
| Second Quarter 2009 | 5% | \$67.50 |
| Third Quarter 2009 | 6% | \$68.25 |

Operating Fleet Plan

The following table provides a fleet summary for Alaska and Horizon for actual airplanes on hand as of the date of this report.

| Alaska Airlines | On Hand | |
|-----------------|---------|--------------|
| | Seats | May 23, 2007 |
| B737-400F** | | 1 |
| B737-400C** | 72 | 4 |
| B737-400 | 144 | 35 |
| B737-700 | 124 | 20 |
| B737-800 | 157 | 22 |
| B737-900 | 172 | 12 |
| MD-80 | 140 | 21 |
| Total | | 115 |

| Horizon Air | On Hand | |
|-------------|---------|--------------|
| | Seats | May 23, 2007 |
| Q200 | 37 | 24 |
| Q400 | 74 | 28 |
| CRJ 700 | 70 | 21 |
| Total | | 73 |

The following table summarizes firm aircraft commitments for Alaska (B737-800) and Horizon (Q400) by year, excluding aircraft that have already been delivered in 2007.

| | 2007 | 2008 | 2009 | 2010 | Thereafter | Total |
|----------|------|------|------|------|------------|-------|
| B737-800 | 7 | 12 | 4 | 6 | 3 | 32 |
| Q-400 | 5 | 3 | 12 | | | 20 |
| Totals | 12 | 15 | 16 | 6 | 3 | 52 |

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In addition to the firm orders noted above, Alaska has options to acquire 49 additional B737-800s and purchase rights for two more. Alaska expects to exercise additional options and purchase rights for B737-800s. Horizon has options to acquire 20 Q400s.

Giving consideration to the current fleet transition plan, the following table displays the currently anticipated fleet count for Alaska and Horizon as of the end of each quarter in 2007 and as of December 31, 2008:

| | 30-Jun-07 | 30-Sep-07 | 31-Dec-07 | 31-Dec-08 |
|------------------------|------------|------------|------------|------------|
| Alaska Airlines | | | | |
| MD80 | 20 | 17 | 15 | |
| 737-400 | 35 | 35 | 34 | 34 |
| 737-400F** | 1 | 1 | 1 | 1 |
| 737-400C** | 4 | 4 | 5 | 5 |
| 737-700 | 20 | 20 | 20 | 20 |
| 737-800* | 22 | 25 | 29 | 42 |
| 737-900 | 12 | 12 | 12 | 12 |
| Totals | 114 | 114 | 116 | 114 |

| | 30-Jun-07 | 30-Sep-07 | 31-Dec-07 | 31-Dec-08 |
|--------------------|-----------|-----------|-----------|-----------|
| Horizon Air | | | | |
| Q200 | 23 | 20 | 17 | 12 |
| Q400 | 32 | 33 | 33 | 36 |
| CRJ-700 | 21 | 21 | 21 | 20 |
| Totals | 76 | 74 | 71 | 68 |

* The total assumes Alaska will identify one airplane for delivery in 2008 from Boeing or a lessor.

** F=Freighter; C=Combination freighter/passenger

Signatures

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

ALASKA AIR GROUP, INC.
Registrant

Date: May 23, 2007

/s/ Brandon S. Pedersen
Brandon S. Pedersen
Vice President/Finance and Controller

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