

ALASKA AIR GROUP INC
Form 8-K
June 22, 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

June 22, 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)

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

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 amounts of potential lease termination payments with lessors for our remaining MD-80 leased aircraft and related 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.

Alaska Airlines

The information below for Alaska 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 Mainline Statistics | Forecast Q2 2007 | Change Yr/Yr |
|---|-----------------------------|-------------------------|
| Capacity (ASMs in millions) | 6,128 | 5% |
| Fuel gallons (000,000) | 89.0 | 1% |
| Cost per ASM as reported on a GAAP basis (cents)* | 10.7-10.8 | (1-2)% |
| Less: Fuel cost per ASM (cents)* | 3.3 | 11% |
| Cost per ASM excluding fuel (cents)* | 7.4-7.5 | (4-6)% |

* 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 and May. See pages 5 and 6 Other Financial Information Calculation of Economic Fuel Cost per Gallon below for additional information regarding fuel costs.

Alaska Mainline Revenue and Traffic

Alaska's May mainline traffic increased 5.7% to 1.582 billion RPMs from 1.496 billion flown a year earlier. Mainline capacity during May was 2.051 billion ASMs, 6.2% higher than the 1.931 billion in May 2006. The mainline passenger load factor (the percentage of available seats occupied by fare-paying passengers) for the month was 77.1%, compared to 77.5% in May 2006. The airline carried 1,533,200 passengers compared to 1,444,200 in May 2006.

Mainline passenger RASM for May 2007 was down 2.3% compared to the prior year as a result of a 1.8% drop in passenger yields and a 0.4-point decline in year-over-year load factor. In April 2007, mainline passenger RASM declined by 2.8%. The decrease was 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 3.2% in May and 1.5% in April 2007 when compared to the prior year. Currently, advance bookings for June indicate a load factor that is down approximately 1.5 points compared to the prior year.

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. As disclosed previously, 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) | 971 | 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)* | 3.8 | 31% |
| Cost per ASM excluding fuel (cents)* | 15.1 | 8% |

* 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 and May. See pages 5 and 6 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.

Horizon Revenue and Traffic

Horizon's May traffic increased 6.1% to 243.3 million RPMs from 229.3 million flown a year earlier. Capacity during May was 327.9 million ASMs, 7.9% higher than 304.0 million in May 2006. The passenger load factor for the month was 74.2%, compared to 75.4% in May 2006. The airline carried 646,600 passengers compared to 583,700 in May 2006.

In May 2007, Horizon's total RASM increased 5.6%, compared to May 2006. The increase in total RASM is affected by changes in the mix of flying among Horizon's lines of business. The year-over-year total RASM increase in April 2007 was 1.6%. Currently, advance bookings for June indicate a load factor that is down approximately 3 to 4 points from the prior year. However, for the network flying (excluding Frontier flying), we expect load factor to be up by approximately 2 points in June 2007.

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

| | % of ASMs |
|--|-----------|
| Horizon brand flying | 50 |
| Capacity Purchase Agreement- Alaska | 35 |
| Capacity Purchase Agreement- Frontier JetExpress | 15 |
| Total | 100 |

Horizon brand flying includes those routes in the Horizon system not covered by the Alaska CPA. Horizon bears the revenue risk in those markets. RASM for brand flying declined 5.0% in May 2007 due to a 6.0% decline in yields, offset by 0.5-point increase in load factor. April RASM was down 10.2% 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 May 31, 2007, Air Group cash and short-term investments totaled approximately \$1.0 billion.

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 and May 2007 (unaudited) | Alaska Airlines | | Horizon Air | |
|--|------------------|--------------------------|------------------|----------------------|
| | (\$ in millions) | Alaska Airlines Cost/Gal | (\$ in millions) | Horizon Air Cost/Gal |
| Raw or into-plane fuel cost | \$ 126.5 | \$ 2.16 | \$ 23.1 | \$ 2.25 |
| Gains on settled hedges | (2.6) | (0.05) | (0.5) | (0.05) |
| Economic fuel expense | \$ 123.9 | \$ 2.11 | \$ 22.6 | \$ 2.20 |
| Adjustments to reflect timing of gain or loss recognition resulting from mark-to-market accounting | 11.8 | 0.20 | 2.3 | 0.22 |
| GAAP fuel expense | \$ 135.7 | \$ 2.31 | \$ 24.9 | \$ 2.42 |

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 | Approximate Crude Oil |
|---------------------|---------------------------|-----------------------|
| | Fuel Requirements | Price per Barrel |
| Second Quarter 2007 | 53% | \$57.31 |
| Third Quarter 2007 | 50% | \$57.12 |
| Fourth Quarter 2007 | 46% | \$60.90 |
| 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 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 | 3 | 3 | 12 | | | 18 |
| Totals | 10 | 15 | 16 | 6 | 3 | 50 |

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.

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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, 2006 and 2008:

| | Seats | 31-Dec-06 | 30-Jun-07 | 30-Sep-07 | 31-Dec-07 | 31-Dec-08 |
|------------------------|--------|-----------|-----------|-----------|-----------|-----------|
| Alaska Airlines | | | | | | |
| 737-200C** | 111 | 2 | | | | |
| 737-400F** | | 1 | 1 | 1 | 1 | 1 |
| 737-400C** | 72 | | 4 | 4 | 5 | 5 |
| 737-400 | 144 | 39 | 35 | 35 | 34 | 34 |
| 737-700 | 124 | 22 | 20 | 20 | 20 | 20 |
| 737-800* | 157 | 15 | 22 | 25 | 29 | 42 |
| 737-900 | 172 | 12 | 12 | 12 | 12 | 12 |
| MD80 | 140 | 23 | 20 | 17 | 15 | |
| Totals | | 114 | 114 | 114 | 116 | 114 |
| Horizon Air | | | | | | |
| | | 31-Dec-06 | 30-Jun-07 | 30-Sep-07 | 31-Dec-07 | 31-Dec-08 |
| Q200 | 37 | 28 | 22 | 19 | 16 | 11 |
| Q400 | 74 | 20 | 31 | 33 | 33 | 36 |
| CRJ-700 | 70 -74 | 21 | 21 | 21 | 21 | 20 |
| Totals | | 69 | 74 | 73 | 70 | 67 |

* 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: June 22, 2007

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