

ALASKA AIR GROUP, INC.  
Form 10-Q  
November 05, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended September 30, 2014

OR

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the transition period from to

Commission File Number 1-8957  
ALASKA AIR GROUP, INC.

Delaware  
(State of Incorporation)

91-1292054  
(I.R.S. Employer Identification No.)

19300 International Boulevard, Seattle, Washington 98188  
Telephone: (206) 392-5040

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes T No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	T	Accelerated filer	£	Non-accelerated filer	£	Smaller reporting company
						£

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes £ No T

The registrant has 132,631,936 common shares, par value \$0.01, outstanding at October 31, 2014.

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ALASKA AIR GROUP, INC.  
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2014

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As used in this Form 10-Q, the terms "Air Group," the "Company," "our," "we" and "us," refer to Alaska Air Group, Inc. and its subsidiaries, unless the context indicates otherwise. Alaska Airlines, Inc. and Horizon Air Industries, Inc. are referred to as "Alaska" and "Horizon," respectively, and together as our "airlines."

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

### Cautionary Note Regarding Forward-Looking Statements

In addition to historical information, this Form 10-Q contains forward-looking statements within the meaning of 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. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words "believe," "expect," "will," "anticipate," "intend," "estimate," "project," "assume" or other similar expressions, although not all forward-looking statements contain these identifying words. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or the Company's present expectations. Some of the things that could cause our actual results to differ from our expectations are:

- the competitive environment in our industry;
- changes in our operating costs, primarily fuel, which can be volatile;
- general economic conditions, including the impact of those conditions on customer travel behavior;
- our ability to meet our cost reduction goals;
- operational disruptions;
- an aircraft accident or incident;
- labor disputes and our ability to attract and retain qualified personnel;
- 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;
- our reliance on automated systems and the risks associated with changes made to those systems;
- changes in laws and regulations.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on which this report was filed with the SEC. We expressly disclaim any obligation to issue any updates or revisions to our forward-looking statements, even if subsequent events cause our expectations to change regarding the matters discussed in those statements. 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 to our shareholders. For a discussion of these and other risk factors, see Item 1A. "Risk Factors" of the Company's annual report on Form 10-K for the year ended December 31, 2013, and Item 1A. "Risk Factors" included herein. Please consider our forward-looking statements in light of those risks as you read this report.

## PART I

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## ALASKA AIR GROUP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in millions)	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$34	\$80
Marketable securities	1,309	1,250
Total cash and marketable securities	1,343	1,330
Receivables - net	178	152
Inventories and supplies - net	64	60
Deferred income taxes	114	113
Prepaid expenses and other current assets	100	107
Total Current Assets	1,799	1,762
Property and Equipment		
Aircraft and other flight equipment	5,100	4,677
Other property and equipment	883	838
Deposits for future flight equipment	511	446
	6,494	5,961
Less accumulated depreciation and amortization	2,250	2,068
Total Property and Equipment - Net	4,244	3,893
Other Assets	193	183
Total Assets	\$6,236	\$5,838

See accompanying notes to condensed consolidated financial statements.

## ALASKA AIR GROUP, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(in millions, except share amounts)	September 30, 2014	December 31, 2013
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$68	\$64
Accrued wages, vacation and payroll taxes	201	211
Other accrued liabilities	680	624
Air traffic liability	703	564
Current portion of long-term debt	115	117
Total Current Liabilities	1,767	1,580
Long-Term Debt, Net of Current Portion	710	754
Other Liabilities and Credits		
Deferred income taxes	738	709
Deferred revenue	356	335
Obligation for pension and postretirement medical benefits	124	123
Other liabilities	312	308
	1,530	1,475
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, \$0.01 par value Authorized: 5,000,000 shares, none issued or outstanding	—	—
Common stock, \$0.01 par value, Authorized: 200,000,000 shares, Issued: 2014 - 133,584,527 shares; 2013 - 137,533,382 shares, Outstanding: 2014 - 133,468,522 shares; 2013 - 137,491,906	1	1
Capital in excess of par value	399	606
Treasury stock (common), at cost: 2014 - 116,005 shares; 2013 - 41,476 shares	(5	) (2
Accumulated other comprehensive loss	(178	) (183
Retained earnings	2,012	1,607
	2,229	2,029
Total Liabilities and Shareholders' Equity	\$6,236	\$5,838

See accompanying notes to condensed consolidated financial statements.

## ALASKA AIR GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions, except per share amounts)	2014	2013	2014	2013
Operating Revenues				
Passenger				
Mainline	\$ 1,030	\$ 960	\$ 2,858	\$ 2,651
Regional	219	208	605	582
Total passenger revenue	1,249	1,168	3,463	3,233
Freight and mail	32	32	88	88
Other - net	184	165	511	433
Special mileage plan revenue	—	192	—	192
Total Operating Revenues	1,465	1,557	4,062	3,946
Operating Expenses				
Wages and benefits	279	285	832	806
Variable incentive pay	30	26	84	68
Aircraft fuel, including hedging gains and losses	394	363	1,112	1,115
Aircraft maintenance	58	54	166	187
Aircraft rent	27	29	84	89
Landing fees and other rentals	74	71	207	207
Contracted services	66	54	188	161
Selling expenses	55	47	154	137
Depreciation and amortization	75	67	218	203
Food and beverage service	24	22	68	63
Other	67	69	229	202
Total Operating Expenses	1,149	1,087	3,342	3,238
Operating Income	316	470	720	708
Nonoperating Income (Expense)				
Interest income	5	5	15	14
Interest expense	(12)	(13)	(36)	(42)
Interest capitalized	5	6	14	15
Other - net	2	(5)	20	(4)
	—	(7)	13	(17)
Income before income tax	316	463	733	691
Income tax expense	118	174	276	261
Net Income	\$ 198	\$ 289	\$ 457	\$ 430
Basic Earnings Per Share:	\$ 1.47	\$ 2.07	\$ 3.35	\$ 3.06
Diluted Earnings Per Share:	\$ 1.45	\$ 2.04	\$ 3.31	\$ 3.02
Shares used for computation:				
Basic	134.865	139.559	136.482	140.304
Diluted	136.158	141.383	137.825	142.213
Cash dividend declared per share:	\$ 0.125	\$ 0.100	\$ 0.375	\$ 0.100
See accompanying notes to condensed consolidated financial statements.				





## ALASKA AIR GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		
(in millions)	2014	2013	2014	2013	
Net Income	\$ 198	\$ 289	\$ 457	\$ 430	
Other comprehensive income (loss):					
Related to marketable securities:					
Unrealized holding gains (losses) arising during the period	(4	) 4	3	(8	)
Reclassification of (gains) losses into Other-net nonoperating income (expense)	(1	) —	(2	) (2	)
Income tax effect	2	(1	) —	4	
Total	(3	) 3	1	(6	)
Related to employee benefit plans:					
Reclassification of net pension expense into Wages and benefits	2	11	7	32	
Income tax effect	(1	) (5	) (3	) (12	)
Total	1	6	4	20	
Related to interest rate derivative instruments:					
Unrealized holding gains (losses) arising during the period	—	(1	) (5	) 9	
Reclassification of (gains) losses into Aircraft rent	2	1	5	4	
Income tax effect	—	1	—	(5	)
Total	2	1	—	8	
Other comprehensive income	—	10	5	22	
Comprehensive income	\$ 198	\$ 299	\$ 462	\$ 452	

See accompanying notes to condensed consolidated financial statements.

## ALASKA AIR GROUP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine Months Ended September 30,	
(in millions)	2014	2013
Cash flows from operating activities:		
Net income	\$457	\$430
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	218	203
Stock-based compensation and other	27	26
Changes in certain assets and liabilities:		
Changes in deferred income taxes	27	121
Increase in air traffic liability	139	93
Increase (decrease) in deferred revenue	21	(147)
Other - net	3	96
Net cash provided by operating activities	892	822
Cash flows from investing activities:		
Property and equipment additions:		
Aircraft and aircraft purchase deposits	(414)	(353)
Other flight equipment	(92)	(16)
Other property and equipment	(53)	(26)
Total property and equipment additions	(559)	(395)
Purchases of marketable securities	(794)	(994)
Sales and maturities of marketable securities	739	712
Proceeds from disposition of assets and changes in restricted deposits	(4)	(3)
Net cash used in investing activities	(618)	(680)
Cash flows from financing activities:		
Proceeds from issuance of debt	51	—
Long-term debt payments	(97)	(139)
Common stock repurchases	(242)	(83)
Dividends paid	(51)	(14)
Other financing activities	19	13
Net cash used in financing activities	(320)	(223)
Net increase (decrease) in cash and cash equivalents	(46)	(81)
Cash and cash equivalents at beginning of year	80	122
Cash and cash equivalents at end of the period	\$34	\$41
Supplemental disclosure:		
Cash paid during the period for:		
Interest (net of amount capitalized)	\$26	\$31
Income taxes	185	100
See accompanying notes to condensed consolidated financial statements.		

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

## NOTE 1. GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## Organization and Basis of Presentation

The interim condensed consolidated financial statements include the accounts of Alaska Air Group, Inc. (Air Group or the Company) and its subsidiaries, Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon), through which the Company conducts substantially all of its operations. All intercompany balances and transactions have been eliminated. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information. Consistent with these requirements, this Form 10-Q does not include all the information required by GAAP for complete financial statements. As a result, this Form 10-Q should be read in conjunction with the Consolidated Financial Statements and accompanying Notes in the Form 10-K for the year ended December 31, 2013. In the opinion of management, all adjustments have been made that are necessary to present fairly the Company's financial position as of September 30, 2014, as well as the results of operations for the three and nine months ended September 30, 2014 and 2013. The adjustments made were of a normal recurring nature.

In preparing these statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities, as well as the reported amounts of revenues and expenses. Due to seasonal variations in the demand for air travel, the volatility of aircraft fuel prices, changes in global economic conditions, changes in the competitive environment, and other factors, operating results for the three and nine months ended September 30, 2014, are not necessarily indicative of operating results for the entire year.

Certain reclassifications, such as changes in our equity structure, have been made to prior year financial statements to conform with classifications used in the current year.

## Recently Issued Accounting Pronouncements

In May 2014, the FASB issued Accounting Standard Update 2014-09, "Revenue from Contracts with Customers" (ASU 2014-09), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

## NOTE 2. CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

Components for cash, cash equivalents and marketable securities (in millions):

September 30, 2014	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash	\$5	\$—	\$—	\$5
Cash equivalents	29	—	—	29
Cash and cash equivalents	34	—	—	34
U.S. government and agency securities	204	—	(1	) 203

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Foreign government bonds	21	—	—	21
Asset-backed securities	166	—	—	166
Mortgage-backed securities	149	1	(1	) 149
Corporate notes and bonds	747	3	(1	) 749
Municipal securities	21	—	—	21
Marketable securities	1,308	4	(3	) 1,309
Total	\$1,342	\$4	\$(3	) \$1,343

December 31, 2013	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash	\$9	\$—	\$—	\$9
Cash equivalents	71	—	—	71
Cash and cash equivalents	80	—	—	80
U.S. government and agency securities	295	1	(2	) 294
Foreign government bonds	11	—	—	11
Asset-backed securities	146	—	—	146
Mortgage-backed securities	144	1	(2	) 143
Corporate notes and bonds	628	4	(2	) 630
Municipal securities	26	—	—	26
Marketable securities	1,250	6	(6	) 1,250
Total	\$1,330	\$6	\$(6	) \$1,330

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence as of September 30, 2014.

Activity for marketable securities (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Proceeds from sales and maturities	\$341	\$247	\$739	\$712
Gross realized gains	1	—	3	3
Gross realized losses	—	—	(1	) (1

Maturities for marketable securities (in millions):

September 30, 2014	Cost Basis	Fair Value
Due in one year or less	\$178	\$178
Due after one year through five years	1,121	1,122
Due after five years through 10 years	8	8
Due after 10 years	1	1
Total	\$1,308	\$1,309

### NOTE 3. DERIVATIVE INSTRUMENTS

#### Fuel Hedge Contracts

The Company's operations are inherently dependent upon the price and availability of aircraft fuel. To manage economic risks associated with fluctuations in aircraft fuel prices, the Company periodically enters into call options for crude oil and historically entered into swap agreements for jet fuel refining margins. Effective in July 2014, the Company no longer enters into refining margin swap agreements.

As of September 30, 2014, the Company had outstanding fuel hedge contracts covering 236 million gallons of crude oil that will be settled from October 2014 to March 2016. Refer to the contractual obligations and commitments section of Item 2 for further information.

#### Interest Rate Swap Agreements

The Company has interest rate swap agreements with a third party designed to hedge the volatility of the underlying variable interest rate in the Company's aircraft lease agreements for six Boeing 737-800 aircraft. The agreements stipulate that the Company pay a fixed interest rate over the term of the contract and receive a floating interest rate. All significant terms of the swap agreement match the terms of the lease agreements, including interest-rate index, rate reset dates, termination dates and

underlying notional values. The agreements expire from February 2020 through March 2021 to coincide with the lease termination dates.

## Fair Values of Derivative Instruments

Fair values of derivative instruments on the consolidated balance sheet (in millions):

	September 30, 2014	December 31, 2013
<b>Derivative Instruments Not Designated as Hedges</b>		
Fuel hedge contracts		
Fuel hedge contracts, current assets	\$3	\$12
Fuel hedge contracts, noncurrent assets	1	4
<b>Derivative Instruments Designated as Hedges</b>		
Interest rate swaps		
Other accrued liabilities	(6	) (7
Other liabilities	(11	) (10
Losses in accumulated other comprehensive loss (AOCL)	(17	) (17

The net cash received (paid) for new positions and settlements was \$1 million and \$6 million during the three months ended September 30, 2014 and 2013, respectively. The net cash received (paid) for new positions and settlements was \$(4) million and \$(3) million during the nine months ended September 30, 2014 and 2013, respectively.

Pretax effect of derivative instruments on earnings (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>Derivative Instruments Not Designated as Hedges</b>				
Fuel hedge contracts				
Gains (losses) recognized in aircraft fuel expense	\$(11	) \$10	\$(17	) \$(39
<b>Derivative Instruments Designated as Hedges</b>				
Interest rate swaps				
Losses recognized in aircraft rent	(2	) (1	) (5	) (4
Gains (losses) recognized in other comprehensive income (OCI)	—	(1	) (5	) 9

The amounts shown as recognized in aircraft rent for cash flow hedges (interest rate swaps) represent the realized losses transferred out of AOCL to aircraft rent. The amounts shown as recognized in OCI are prior to the losses recognized in the income statement as aircraft rent during the period. The Company expects \$6 million to be reclassified from AOCL to aircraft rent within the next twelve months.

## Credit Risk and Collateral

The Company is exposed to credit losses in the event of nonperformance by counterparties to these derivative instruments. To mitigate exposure, the Company periodically evaluates the counterparties' potential risk of nonperformance by monitoring the absolute exposure levels and credit ratings. The Company maintains security agreements with a number of its counterparties which may require the Company to post collateral if the fair value of the selected derivative instruments fall below specified mark-to-market thresholds. The posted collateral does not

offset the fair value of the derivative instruments and is included in "Prepaid expenses and other current assets" on the consolidated balance sheet.



The Company posted collateral of \$9 million and \$7 million as of September 30, 2014 and December 31, 2013, respectively. The collateral was provided to one counterparty associated with the net liability position of the interest rate swap agreements, offset by the net asset position of the fuel hedge contracts under a master netting arrangement.

#### NOTE 4. FAIR VALUE MEASUREMENTS

##### Fair Value of Financial Instruments on a Recurring Basis

Fair values of financial instruments on the consolidated balance sheet (in millions):

September 30, 2014	Level 1	Level 2	Total
Assets			
Marketable securities			
U.S. government and agency securities	\$203	\$—	\$203
Foreign government bonds	—	21	21
Asset-backed securities	—	166	166
Mortgage-backed securities	—	149	149
Corporate notes and bonds	—	749	749
Municipal securities	—	21	21
Derivative instruments			
Fuel hedge call options	—	4	4
Liabilities			
Derivative instruments			
Interest rate swap agreements	—	(17)	(17)
December 31, 2013			
Assets			
Marketable securities			
U.S. government and agency securities	\$294	\$—	\$294
Foreign government bonds	—	11	11
Asset-backed securities	—	146	146
Mortgage-backed securities	—	143	143
Corporate notes and bonds	—	630	630
Municipal securities	—	26	26
Derivative instruments			
Fuel hedge call options	—	16	16
Liabilities			
Derivative instruments			
Interest rate swap agreements	—	(17)	(17)

The Company uses the market and income approach to determine the fair value of marketable securities. U.S. government securities are Level 1 as the fair value is based on quoted prices in active markets. Foreign government bonds, asset-backed securities, mortgage-backed securities, corporate notes and bonds, and municipal securities are Level 2 as the fair value is based on industry standard valuation models that are calculated based on observable inputs such as quoted interest rates, yield curves, credit ratings of the security and other observable market information.

The Company uses the market approach and the income approach to determine the fair value of derivative instruments. Fuel hedge contracts that are not traded on a public exchange are Level 2 as the fair value is primarily

based on inputs which are readily available in active markets or can be derived from information available in active markets. The fair value for call options is determined utilizing an option pricing model based on inputs that are readily available in active markets, or can be derived from information available in active markets. In addition, the fair value considers the exposure to credit losses in the

event of nonperformance by counterparties. Interest rate swap agreements are Level 2 as the fair value of these contracts is determined based on the difference between the fixed interest rate in the agreements and the observable LIBOR-based forward interest rates at period end, multiplied by the total notional value.

The Company has no financial assets that are measured at fair value on a nonrecurring basis at September 30, 2014.

#### Fair Value of Other Financial Instruments

The Company used the following methods and assumptions to determine the fair value of financial instruments that are not recognized at fair value as described below.

Cash and Cash Equivalents: Carried at amortized cost, which approximates fair value.

Debt: The carrying amount of the Company's variable-rate debt approximates fair values. For fixed-rate debt, the Company uses the income approach to determine the estimated fair value, by using discounted cash flow using borrowing rates for comparable debt over the weighted life of the outstanding debt. The estimated fair value of the fixed-rate debt is Level 3 as certain inputs used are unobservable.

Fixed-rate debt that is not carried at fair value on the consolidated balance sheet and the estimated fair value of long-term fixed-rate debt (in millions):

	September 30, 2014	December 31, 2013
Carrying amount	\$633	\$703
Fair value	687	762

#### NOTE 5. MILEAGE PLAN

Alaska's Mileage Plan liabilities and deferrals on the consolidated balance sheets (in millions):

	September 30, 2014	December 31, 2013
Current Liabilities:		
Other accrued liabilities	\$346	\$314
Other Liabilities and Credits:		
Deferred revenue	348	323
Other liabilities	21	19
Total	\$715	\$656

Alaska's Mileage Plan revenue included in the consolidated statements of operations (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Passenger revenues	\$62	\$54	\$180	\$150
Other - net revenues	77	74	223	184
Special mileage plan revenue	—	192	—	192
Total	\$139	\$320	\$403	\$526

## NOTE 6. LONG-TERM DEBT

Long-term debt obligations on the consolidated balance sheet (in millions):

	September 30, 2014	December 31, 2013	
Fixed-rate notes payable due through 2024	\$633	\$703	
Variable-rate notes payable due through 2025	192	168	
Long-term debt	825	871	
Less current portion	115	117	
Total	\$710	\$754	
Weighted-average fixed-interest rate	5.7	% 5.7	%
Weighted-average variable-interest rate	1.6	% 1.7	%

During the nine months ended September 30, 2014, the Company made debt payments of \$97 million. In addition, the company financed \$51 million for the three Q400's that were delivered in Q4 2013.

At September 30, 2014, long-term debt principal payments for the next five years and thereafter are as follows (in millions):

	Total
Remainder of 2014	\$23
2015	116
2016	115
2017	121
2018	151
Thereafter	299
Total	\$825

## Bank Lines of Credit

The Company has two \$100 million credit facilities. Both facilities have variable interest rates based on LIBOR plus a specified margin. One of the \$100 million facilities, which expires in September 2017, is secured by aircraft. The other \$100 million facility, which expires in March 2017, is secured by certain accounts receivable, spare engines, spare parts and ground service equipment. The Company has no immediate plans to borrow using either of these facilities. These facilities have a requirement to maintain a minimum unrestricted cash and marketable securities balance of \$500 million. The Company is in compliance with this covenant at September 30, 2014.

## NOTE 7. EMPLOYEE BENEFIT PLANS

Net periodic benefit costs recognized included the following components for the three months ended September 30, 2014 (in millions):

	Three Months Ended September 30,				Postretirement Medical	
	Qualified		Nonqualified		2014	2013
	2014	2013	2014	2013		
Service cost	\$8	\$11	\$—	\$—	\$1	\$1
Interest cost	21	19	—	—	1	1
Expected return on assets	(30)	(27)	—	—	—	—
Amortization of prior service cost—		(1)	—	—	—	—
Recognized actuarial loss (gain)	3	11	—	—	(1)	—

Total	\$2	\$13	\$—	\$—	\$1	\$2
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Net periodic benefit costs recognized included the following components for the nine months ended September 30, 2014 (in millions):

	Nine Months Ended September 30,					
	Qualified		Nonqualified		Postretirement Medical	
	2014	2013	2014	2013	2014	2013
Service cost	24	34	—	1	2	3
Interest cost	61	55	1	1	3	3
Expected return on assets	(88)	(82)	—	—	—	—
Amortization of prior service cost	(1)	(1)	—	—	—	—
Recognized actuarial loss	10	32	—	—	(2)	—
Total	6	38	1	2	3	6

#### NOTE 8. COMMITMENTS

Future minimum fixed payments for commitments (in millions):

September 30, 2014	Aircraft Leases	Facility Leases	Aircraft Commitments	Capacity Purchase Agreements	Engine Maintenance
Remainder of 2014	\$11	\$23	\$77	\$13	\$3
2015	107	90	331	44	10
2016	84	88	359	32	13
2017	54	84	382	32	—
2018	39	36	430	14	—
Thereafter	52	207	1,044	—	—
Total	\$347	\$528	\$2,623	\$135	\$26

#### Lease Commitments

At September 30, 2014, the Company had lease contracts for 57 aircraft, which have remaining noncancelable lease terms ranging from 2015 to 2022. Of these aircraft, 14 are non-operating (i.e. not in the Company's fleet) and subleased to third-party carriers. The majority of airport and terminal facilities are also leased. Rent expense for aircraft and facility leases was \$74 million and \$75 million for the three months ended September 30, 2014 and 2013, respectively, and \$215 million and \$228 million for the nine months ended September 30, 2014 and 2013, respectively.

#### Aircraft Commitments

As of September 30, 2014, the Company is committed to purchasing 64 B737 aircraft (27 737-900ER aircraft and 37 737 MAX aircraft) and one Q400 aircraft, with deliveries in 2014 through 2022. In addition, the Company has options to purchase 58 additional B737 aircraft and seven Q400 aircraft.

Subsequent to September 30, 2014, the Company exercised 10 options for 737-900ER aircraft with deliveries in 2016 and 2017.

#### Capacity Purchase Agreements (CPAs)

At September 30, 2014, Alaska had CPAs with three carriers, including the Company's wholly-owned subsidiary, Horizon. Horizon sells 100% of its capacity to Alaska under a CPA, which is eliminated upon consolidation. In addition, Alaska has CPAs with SkyWest Airlines, Inc. (SkyWest) to fly certain routes and Peninsula Airways, Inc.

(PenAir) to fly one route in the state of Alaska. Under these agreements, Alaska pays the third-party carriers an amount which is based on a determination of their cost of operating those flights and other factors. The costs paid by Alaska to Horizon are based on similar data and are intended to approximate market rates for those services. Future payments (excluding those due to Horizon) are based on contractually required minimum levels of flying by the third-party carriers, which could differ materially due to variable payments based on actual levels of flying and certain costs associated with operating flights, such as fuel.

## Engine Maintenance

The Company has a power-by-the-hour (PBH) maintenance agreement for some of the engines equipped on 737-700 and 737-900 aircraft. This agreement transfers risk to a third-party service provider and fixes the amount the Company pays per flight hour in exchange for maintenance and repairs under a predefined maintenance program. Future payments are based on minimum flight hours.

## NOTE 9. SHAREHOLDERS' EQUITY

## Dividends

During the three months ended September 30, 2014, the Company declared and paid a cash dividend of \$0.125 per share, or \$17 million. During the nine months ended September 30, 2014, the Company declared and paid cash dividends of \$0.375 per share, or \$51 million.

## Common Stock Repurchase

In September 2012, the Board of Directors authorized a \$250 million share repurchase program, which was completed in July 2014. In May 2014, the Board of Directors authorized a \$650 million share repurchase program, which began immediately after the \$250 million program was completed.

Share repurchase activity (in millions, except share amounts):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014 Shares	Amount	2013 Shares	Amount	2014 Shares	Amount	2013 Shares	Amount
2014 Repurchase Program - \$650 million	3,438,723	\$ 159	—	\$—	3,438,723	\$ 159	—	\$—
2012 Repurchase Program - \$250 million	5,268	\$—	1,074,016	\$32	1,819,304	\$83	2,909,580	\$83
Total	3,443,991	\$ 159	1,074,016	\$32	5,258,027	\$242	2,909,580	\$83

## Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive income (loss), net of tax (in millions):

	September 30, 2014	December 31, 2013
Marketable securities	\$1	\$—
Employee benefit plans	(169)	(173)
Interest rate derivatives	(10)	(10)
Total	\$(178)	\$(183)

## Earnings Per Share (EPS)

Diluted EPS is calculated by dividing net income by the average number of common shares outstanding plus the number of additional common shares that would have been outstanding assuming the exercise of in-the-money stock options and restricted stock units, using the treasury-stock method. For the three and nine months ended September 30, 2014 and 2013, anti-dilutive shares excluded from the calculation of EPS were not material.





## NOTE 10. OPERATING SEGMENT INFORMATION

Air Group has two operating airlines - Alaska Airlines and Horizon Air. Each is a regulated airline with separate management teams primarily in operational roles. Horizon sells 100% of its capacity to Alaska under a CPA, which is eliminated upon consolidation. In addition, Alaska has CPAs with SkyWest to fly certain routes and PenAir to fly one route in the state of Alaska. The Company attributes revenue between Mainline and Regional based on the coupon fare in effect on the date of issuance relative to the origin and destination of each flight segment. To manage the two operating airlines and the revenues and expenses associated with the CPAs, management views the business in three operating segments.

Alaska Mainline - Flying Boeing 737 jets and all associated revenues and costs.

Alaska Regional - Alaska's CPAs with Horizon, SkyWest and PenAir. In this segment, Alaska Regional records actual on-board passenger revenue, less costs such as fuel, distribution costs, and payments made to Horizon, SkyWest and PenAir under the respective CPAs. Additionally, Alaska Regional includes an allocation of corporate overhead such as IT, finance, and other administrative costs incurred by Alaska on behalf of Horizon.

Horizon - Horizon operates turboprop Q400 aircraft. All of Horizon's capacity is sold to Alaska under a CPA. Expenses include those typically borne by regional airlines such as crew costs, ownership costs, and maintenance costs. The results of Horizon's operations are eliminated upon consolidation.

Additionally, the following table reports "Air Group adjusted," which is not a measure determined in accordance with GAAP. The Company's chief operating decision-makers and others in management use this measure to evaluate operational performance and determine resource allocations. Adjustments are further explained below in reconciliation to consolidated GAAP results. Operating segment information is as follows (in millions):

Three Months Ended September 30, 2014

Alaska

	Mainline	Regional	Horizon	Consolidating	Air Group Adjusted <sup>(a)</sup>	Special Items <sup>(b)</sup>	Consolidated	
Operating revenues								
Passenger								
Mainline	\$ 1,030	\$—	\$—	\$—	\$ 1,030	\$—	\$ 1,030	
Regional	—	219	—	—	219	—	219	
Total passenger revenues	1,030	219	—	—	1,249	—	1,249	
CPA revenues	—	—	99	(99	) —	—	—	
Freight and mail	30	2	—	—	32	—	32	
Other - net	161	22	1	—	184	—	184	
Total operating revenues	1,221	243	100	(99	) 1,465	—	1,465	
Operating expenses								
Operating expenses, excluding fuel	605	162	85	(97	) 755	—	755	
Economic fuel	338	52	—	—	390	4	394	
Total operating expenses	943	214	85	(97	) 1,145	4	1,149	
Nonoperating income (expense)								
Interest income	5	—	—	—	5	—	5	
Interest expense	(8	) —	(4	) —	(12	) —	(12	)
Other	7	—	—	—	7	—	7	
	4	—	(4	) —	—	—	—	
Income (loss) before income tax	\$282	\$29	\$11	\$(2	) \$ 320	\$(4	) \$316	



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Three Months Ended September 30, 2013

Alaska

	Mainline	Regional	Horizon	Consolidating	Air Group Adjusted <sup>(a)</sup>	Special Items <sup>(b)</sup>	Consolidated	
Operating revenues								
Passenger								
Mainline	\$960	\$—	\$—	\$—	\$ 960	\$—	\$960	
Regional	—	208	—	—	208	—	208	
Total passenger revenues	960	208	—	—	1,168	—	1,168	
CPA revenues	—	—	88	(88	) —	—	—	
Freight and mail	31	1	—	—	32	—	32	
Other - net	145	19	1	—	165	192	357	
Total operating revenues	1,136	228	89	(88	) 1,365	192	1,557	
Operating expenses								
Operating expenses, excluding fuel	588	144	80	(88	) 724	—	724	
Economic fuel	337	46	—	—	383	(20	) 363	
Total operating expenses	925	190	80	(88	) 1,107	(20	) 1,087	
Nonoperating income (expense)								
Interest income	5	—	—	—	5	—	5	
Interest expense	(9	) —	(4	) —	(13	) —	(13	)
Other	8	(8	) 1	—	1	—	1	
	4	(8	) (3	) —	(7	) —	(7	)
Income (loss) before income tax	\$215	\$30	\$6	\$—	\$ 251	\$212	\$463	

Nine Months Ended September 30, 2014

Alaska

	Mainline	Regional	Horizon	Consolidating	Air Group Adjusted <sup>(a)</sup>	Special Items <sup>(b)</sup>	Consolidated
Operating revenues							
Passenger							
Mainline	\$2,858	\$—	\$—	\$—	\$ 2,858	\$—	\$2,858
Regional	—	605	—	—	605	—	605
Total passenger revenues	2,858	605	—	—	3,463	—	3,463
CPA revenues	—	—	277	(277	) —	—	—
Freight and mail	84	4	—	—	88	—	88
Other - net	448	59	4	—	511	—	511
Total operating revenues	3,390	668	281	(277	) 4,062	—	4,062
Operating expenses							
Operating expenses, excluding fuel	1,783	464	257	(274	) 2,230	—	2,230
Economic fuel	980	149	—	—	1,129	(17	) 1,112
Total operating expenses	2,763	613	257	(274	) 3,359	(17	) 3,342

Nonoperating income  
(expense)

Interest income	15	—	—	—	15	—	15	
Interest expense	(25	) (1	) (10	) —	(36	) —	(36	)
Other	34	—	—	—	34	—	34	
	24	(1	) (10	) —	13	—	13	
Income (loss) before income tax	\$651	\$54	\$14	\$(3	) \$716	\$17	\$733	

## Nine Months Ended September 30, 2013

## Alaska

	Mainline	Regional	Horizon	Consolidating	Air Group Adjusted <sup>(a)</sup>	Special Items <sup>(b)</sup>	Consolidated	
Operating revenues								
Passenger								
Mainline	\$2,651	\$—	\$—	\$—	\$ 2,651	\$—	\$2,651	
Regional	—	582	—	—	582	—	582	
Total passenger revenues	2,651	582	—	—	3,233	—	3,233	
CPA revenues	—	—	274	(274	) —	—	—	
Freight and mail	85	3	—	—	88	—	88	
Other - net	380	49	4	—	433	192	625	
Total operating revenues	3,116	634	278	(274	) 3,754	192	3,946	
Operating expenses								
Operating expenses, excluding fuel	1,704	440	253	(274	) 2,123	—	2,123	
Economic fuel	987	135	—	—	1,122	(7	) 1,115	
Total operating expenses	2,691	575	253	(274	) 3,245	(7	) 3,238	
Nonoperating income (expense)								
Interest income	14	—	—	—	14	—	14	
Interest expense	(30	) —	(10	) (2	) (42	) —	(42	)
Other	19							