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ALK - Q2 2019 Alaska Air Group Inc Earnings Call

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OVERVIEW:

Co. reported 2Q19 total revenues of $2.3b and GAAP net income of $262m.

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PRESENTATION

Operator

Good afternoon. My name is Thea, and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group Second Quarter Earnings Release Conference Call. Today's call is being recorded and will be accessible for future playback at www.alaskaair.com. All lines have been placed on mute to prevent any background noise. After the speakers remarks there will be a question and answer session for analysts. If you wish to ask a question please press *1 on your telephone keypad. If you would like to withdraw you question press the # key.

Thank you. I would like to turn the call over to Alaska Air Group's Vice President of Finance and Controller, Chris Berry.

Christopher Michael Berry - *Alaska Air Group, Inc. - VP of Finance & Controller*

Thank you, Thea. Good afternoon, everyone, and thank you for joining us for our second quarter 2019 earnings call.

It's good to be back with you all. In today's prepared remarks, you will hear updates from our leaders Brad Tilden; Ben Minicucci; Andrew Harrison and Brandon Pedersen. Several other members of our management team are also here to answer your questions during the Q&A portion of the call.

This afternoon, Alaska Air Group reported second quarter GAAP net income of $262 million, excluding merger-related costs, mark-to-market fuel hedging adjustments, Air Group reported adjusted net income of $270 million and adjusted earnings per share of $2.17, ahead of the first Call consensus.

These results compare to adjusted net income of $206 million and adjusted earnings per share of $1.66 in the second quarter of 2018. Our adjusted pretax margin expanded 300 basis points and our earnings per share grew 31%. We generated $735 million in free cash flow and we paid down an additional $140 million of debt during the quarter, bringing our total debt payment up to $1.2 billion of the $2 billion we borrowed for the Virgin America acquisition.

This quarter marked great progress toward our long-term goal of 13% to 15% pretax margins.

And as a reminder, our comments today will include forward looking statements on our expected future performance, which may differ materially from actual results. Information on risk factors that could affect our business can be found in our SEC filings. On today's call, we will refer to certain non-GAAP financial measures such as adjusted earnings and unit cost, excluding fuel. And as usual, we have provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in today's earnings release.

And now I'll turn the call over to Brad for his opening remarks.

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

Thanks, very much, Chris, and good afternoon, everybody. We're now 2.5 years past our acquisition of Virgin America. The vast majority of the integration work is now done and we're beginning to realize the benefits from our significantly expanded network and the synergies for bringing the 2 airlines together. We've integrated our work groups, our reservation system and our back office functions faster than any other major airline integration. And with our relentless focus on low fares and low costs, best-in-class customer service, the industry's most generous Mileage Plan, a fuel-efficient fleet, a well-loved brand and a fortress balance sheet, we are well setup to move towards our targeted annual growth and our targeted pretax margin of 13% to 15% over the business cycle.

We made great progress executing our plan this quarter with a 300 basis point improvement in our margin and we're implementing initiatives that we shared with you at our Investor Day last November to drive further margin expansion in the quarters and years ahead.

As you know, we as a leadership team, are fully committed to producing the right margins and returns for our owners given the $8 billion of capital that you've invested so that we can invest in our growth and provide the right benefits for all of the people who depend on us.

Our long-time formula of focusing on high productivity, high asset utilization and low overhead is working. I want to thank our operating division leaders for their cost performance relative to plan so far this year. In fact, given solid cost savings from plan, our team was able to maintain our full year cost guidance, even after adding back the cost of new labor deals.

And on that topic, we were really proud to announce 2 new labor deals this quarter. First, a 2-year extension with our aircraft technicians, which allows all of our Alaska mechanics to work on all of our mainline aircraft. And this is an agreement which has been both negotiated and ratified. And second, a 5-year extension with the 5,200 employees represented by the IAM, which is being voted upon as we speak.

We're pleased to come to these agreements with the finest employees in the business and we're hopeful that the agreement with our IAM represented folks ratifies in the coming weeks.

On the revenue side, I thought we also had a good results this quarter. I want to thank our teams in revenue management, e-commerce and marketing, who had the best improvement in unit revenue that we've seen in the past 30 quarters.

We're currently in the middle of the busy summer travel season and our people are running an excellent operation and taking great care of our guests. Genuine and caring service is what makes Alaska different. And we're all so proud of our 22,000 folks at Alaska and Horizon for earnings their 12th consecutive J.D. Power award. Along with other recognition we've received from the American Customer Satisfaction Index, Condé Nast, Travel & Leisure, Wallethub and many more. It's clear that our folks are doing a terrific job.

The J.D. Power award is especially gratifying this year as we passed the 800 point mark for the first time in our history, and as it was the final award in the traditional network category -- carrier category as the categories of change going forward.

Our results for the first half of the year make us optimistic about the rest of 2019 and beyond. As you all know, we're running our business so that this will be a great place for our people to work, a great place for our customers to fly and very importantly, a great place for our owners to invest. We've got more work to do to execute our plan and we're fully focused on getting that work done.

And with that, I'll turn the call over to 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. In the second quarter, total revenues grew 6.1% to $2.3 billion on a 1% increase in capacity as unit revenues increased 5.2%, well ahead of our initial guide of 3.5%.

Our pretax margin was 15.8%, 300 basis points better than prior year and our adjusted earnings per share improved 31%. As Brad mentioned, we still have plenty of work ahead of us but the momentum is encouraging. For example, the recently ratified transition agreement, an integrated seniority list with our technicians, brings our Boeing and Airbus mechanics together and provides a 2-year extension, giving our technicians and the company more certainty through 2023. The agreement recognizes the high caliber of our maintenance team with pay increases, signing bonus and enhanced productivity. This integrated agreement is a significant milestone at Alaska as we now have joint agreements, an integrated seniority list with all of our workgroups in less than 3 years from the date we acquired Virgin America. It is a huge accomplishment and allows us to come together as one team, continue to build on our strong culture and fully leverage the synergies we planned from the acquisition.

I also want to thank our 5,200 IAM represented employees for their absolute professionalism over the past several months, as we finalize the recently announced tentative agreement for a new 5-year collective bargaining agreement. With our last deal signed over 5 years ago, this group was the furthest out of market amongst all of our labor groups and represents about 25% of our employees. We won't know the results of the vote for a few more weeks but I'm excited to get these well-deserved raises and improvements to our folks, who represent Alaska so well and deliver outstanding gift service day in and day out.

These 2 agreements will increase our wages and benefit cost by approximately $50 million annually, and about $48 million this year, including onetime signing bonuses and other costs of approximately $24 million. The impact of these new agreements is included in our cost guidance today. We are pleased to come to these agreements and we want to thank the IAM and AMFA for their continued partnership as we work together to provide great wages and benefits for our people and set the stage for a successful financial future.

Our focus over the next few years is on implementing the initiatives on our road map to build brand strength, improve our product and guest experience and to strengthen our financial muscle as we strive toward a best-in-class investment for our long-term owners.

Looking back on the second quarter, here are some of our biggest accomplishments. First, as Brad mentioned, our employees were awarded with our 12th consecutive J.D. Power award, a true testament to the exceptionalism of our people. I couldn't be more proud of the hard work they've put in everyday to take care of our guests and run a great operation. Second, we are now realizing the full run rate of the $330 million of revenue initiatives and synergies we launched over the last several months. This includes the increased benefit from the cross fleeting of our higher gauge, lower unit cost Boeing aircraft into the most capacity-constraint markets with overflow demand. We should see the biggest impact from these changes during the peak summer travel season in Q3. Third, we completed the painting on all of our Airbus aircraft and we are 25% through the interior renovations, which will provide more premium seating and increased revenue per aircraft. Fourth, after a rough operational start to the year, due to the Pacific Northwest storms, we have climbed our way back to first-place year-to-date for on-time departures and second place in DOT on-time arrivals. I'd be happy to address the nuance of those 2 measures in Q&A.

For the second quarter, we were first among the top carriers in both of these categories. And on the regional side, Horizon is topping the leaderboard when it comes to operational performance. #1 in the regional industry, year-to-date, by a wide margin. I want to give a shout out to the entire team at Horizon for a complete turnaround of their performance over the past couple of years. Each of these along with the every day accomplishments of our teams across the company is pushing us to be better tomorrow than we are today. We talk a lot around here about turning the dial, a little each day to make incremental improvements. We are always pushing ourselves to be better, so as we continue to turn the dial and with the wind now at our back, I'm confident in our team's ability to outperform.

And with that, I will turn the call over to Andrew for his commercial update.

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

Thanks, Ben, and good afternoon, everyone. My comments this afternoon will focus on the second quarter revenue performance, guest-facing initiatives and revenue guidance for the third quarter. The 5.2% improvement in unit revenues was a welcome result of what was a volatile revenue environment in the first quarter and represents our best unit revenue improvement over the past 7 years and our best absolute Q2 RASM in the past 3 years. Industry pricing stabilized for the most part as we ended the second quarter, which included the dissipation of low-closing fares. As we entered this year, we had a goal of outperforming industry RASM by approximately 200 basis points. We beat industry RASM by approximately 190 basis points this quarter. Ex MAX-related unit revenue outliers for some carriers, our revenue initiatives and synergies delivered on that goal.

Breaking Q2 down further, I'd like to provide a bit more detail on the year-over-year unit revenue increase. First in terms of challenges. Although not as impactful as the first quarter, we continue to see softness in Hawaii pricing due to the significant year-over-year growth in overlapping, weighted competitive capacity of 6% to 7%. We also saw increased industry capacity from the lower 48 into the state of Alaska, putting some pressure on our long-haul Alaska yields. This competitive capacity continues through the peak summer period. These 2 regions represent about 22% of our system, with unit revenues negatively impacted by about 50 basis points, which is less than what we had originally guided to.

Turning to the positive, our strong unit revenue performance was driven by the following key areas. First, our synergies and initiatives continued to ramp and they reach their full run rate during this quarter. These initiatives improved our Q2 RASM by 350 basis points, which we guided to on our first quarter call, with Saver Fares the largest contributor to this improvement. We continue to feel confident in the $330 million of combined 2019 initiatives and synergies we guided to at Investor Day last November.

Second, we had tailwinds of about 100 basis points from the Easter shift and another 100 basis points from changes in our award redemption structure, that had negatively impacted RASM in Q2 last year after our reservation system cut over when redemptions got away from us.

Third, underlying pricing stabilized and steadily improved through the quarter. 9 of our 11 operating regions representing 88% of our capacity, experienced positive year-over-year unit revenues, including California transcon markets, that were significantly impacted by pricing actions in Q1. A quick note on transcon markets, I want to thank all of our operational and commercial teams that have rallied around improving our performance in this region. We've made several changes, including more focused marketing, cross fleeting and a concerted effort to improve both cancel rates and on-time performance. But most importantly, our station and in-flight crews have been focused on delivering consistently great guest service, all to help improve the financial performance and guest experience of these important routes, and it's working. Although we have ways to go, we did experience significant improvement in RASM and double-digit increases in California transcon margins year-over-year and we see continued momentum as we head into Q3.

And lastly, we continue to see strength in our royalty revenues, which increased 5.7% on flat passengers. The percentage of our flyers during the quarter that were Mileage Plan members and credit cardholders improved 2.7 points and 1.2 points, respectively, which is very encouraging. As we've mentioned in previous calls, the commercial team is focused on a number of network and product enhancements this year that our guests have embraced. First, our Alaska Global Partners network is expanding again with our new partnership with El Al, with new direct flights out of San Francisco to Tel Aviv. This is in addition to the direct service to Hong Kong, Tokyo, Singapore and Dublin, that have all been added or announced from Seattle by our partners. With our 17 global partners, their Mileage Plan members can earn and redeem miles to more than 900 destinations worldwide.

Second, as Ben mentioned, we are installing new cabin interiors on our Airbus and 737-700 aircraft, that both align and improve the guest experience. We've completed 25 so far. Each Airbus renovation increases total seat count and builds in a greater mix of First and Premium Class seats. These are beautiful aircraft and our guess reaction has been extremely positive. Third, we've now completed satellite Wi-Fi installation on 44 of our mainline aircraft, and the feedback from our guess has just been fantastic. This, along with our in-flight entertainment boasting the most movies in the sky, provides our guests with a top-notch, in-flight experience. In fact, our entire regional jet fleet is also equipped with Wi-Fi and on board entertainment.

And finally, 2 weeks ago, we opened Phase 1 of a stunning new wing of the North Satellite terminal here in Seattle, featuring our new 16,000 square-foot flagship lounge for our guests. We've also started construction on our rooftop lounge in San Francisco that we expect to open next year.

So looking to Q3. Our capacity growth picks up modestly to approximately 3%, and our Q3 RASM guidance, that ranges 2% to 5%, reflecting the benefit of our many revenue initiatives and merger synergies, our expectation of stable pricing through the peak summer season, offset by continued pressures we are seeing in Hawaii, and long-haul Alaska flying that I mentioned earlier. We are designing our product, network and revenue-management processes to enable growth with the financial objective to achieve our 13% to 15% long-term pretax margin goals. In fact, we've recently announced that we are implementing a new state-of-the-art Amadeus revenue management system, which will be fully deployed by next year -- by the middle of next year and will result in better revenue performance in our 2020 and beyond. With the structural changes we've made to our revenue model, we continue to feel confident in our 2019 objective to outperform industry RASM and look forward to building on this solid platform for years to come.

And with that, I'll turn the call over to Brandon.

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

Thanks, Andrew, and good afternoon, everybody. Our second quarter adjusted net profit of $270 million and earnings per share of $2.17 were both 31% better than the second quarter of 2018. This marks our second consecutive year-over-year improvement in quarterly margins and is the largest year-over-year margin increase since Q2 of 2016. It's evidenced that our plan to improve returns is working.

Andrew touched on the revenue performance, so I'll touch on cost performance for Q2 and the outlook for the rest of 2019. We setup this year with an aggressive plan to keep unit cost growth to between 2% and 2.5% on a roughly 2% increase in capacity. No small task, given the cost pressures we've faced and before the impact of any new labor deals. Teams across the company have risen to the occasion and managed costs in the first half of the year in such a way that we've been able to maintain full year cost guidance that falls at the low end of our initial range, even after absorbing the impact of the AMFA and IAM deals that Ben talked about. These agreements will add approximately $50 million annually with approximately $48 million impacting this year, including $24 million in the back half of this year, base wages, and $24 million in signing bonuses that we expect to pay in Q3.

For the full year, we now expect non-fueling unit costs to grow by 2.2% all-in. Looking at the quarter, unit cost ex fuel rose by 2.3%, much better than the -- our initial guidance of plus 5%. Much of the beat is solid execution, although some of the outperformance is a result of certain costs shifting to the back half of 2019.

Pilot training costs are a great example, as cross bidding between mainline fleet types is now happening but a little later than expected. This will put pressure on pilot productivity, shifting up to $15 million of training costs into Q3 and Q4 from the first half of the year. Nevertheless, we continue to see encouraging improvements in productivity and our ability to control overhead costs.

Let me provide a few examples. First, Horizon's overall productivity, measured by passengers per FTE, is up 3.3% this quarter and unit costs ex fuel are down 16% on 20% capacity growth. Productivity in the flight ops division is a particularly bright spot as training costs have declined significantly and hard time has improved, especially on the E175. I want to congratulate the Horizon team on these fantastic results.

Second, as we mentioned on our last call, our supply chain team has been working a plan to lower prices we pay to our vendor partners. Their results have been outstanding. We expect to save more than $30 million this year, positively impacting costs across many divisions.

A third example relates to flight attendant premium pay. During the transition, we had a heavy reliance on premium pay to make sure our flights were all covered. Today, our in-flight team is having to use much less of it because of a much more normalized operation and better processes in the department.

And finally, overhead is down by more than $15 million or about 5% so far this year. Over the last year we've made changes to the size of our management staff, not only to save payroll costs, but more importantly, to improve our speed and agility and reduce the number of layers between our leaders and both our customers and our front-line employees. These changes are important as we seek to more positively and tightly manage our company towards the future that we are seeking.

Looking to Q3, we expect CASM to be up approximately 5% on a 3% increase in capacity, which, given our full year guidance, would imply a 1.2% decline in unit costs in the fourth quarter. The third quarter increase reflects the cost shifts I mentioned, timing of expected variable pay accruals and the impact of the new labor agreements, including our expectation that will pay, as I said earlier, $24 million in onetime cost during the quarter.

July marks the beginning of our annual planning process. As we think about 2020, we're mindful of our need to continue to aggressively manage our unit costs in a way that maintains or expands our competitive cost moat versus the legacy carriers. Doing so ensures that we can offer low fares, grow and achieve our 13% to 15% long-term margin target.

Turning to the balance sheet. We ended the quarter with $1.6 billion in cash and marketable securities. Total cash flow from operations for the first 6 months of the year was nearly $1.1 billion ex merger-related costs, while net CapEx was $330 million. This resulted in $735 million of free cash flow, again, ex integration costs, which was nearly $400 million higher than the first 6 months of 2018.

At consensus, full year operating cash flow would be about $1.5 billion and free cash flow would be about $775 million, assuming CapEx of $725 million this year. That's more than 3x the amount we produced in 2018. The result is a direct outcome of our decision in early 2018 to reduce capital spending in order to improve free cash flow. We've produced free cash flow for 9 years in a row and positive operating cash flow for more than 30 consecutive years. Maintaining this track record of positive free cash flow is an important part of our capital-allocation strategy.

Our fortress balance sheet was also a hallmark for this company -- of this company for many years and we're quickly moving back to that position. We've repaid $280 million in debt so far this year, including some repayments that were made in June that will offset with some new borrowings in the third quarter as part of our broader effort to take advantage of the low-rate environment, lower our borrowing costs and move to more fixed-rate debt, given the tight spreads and inverted yield curve. I want to give a shout out to our treasury team for the work they've been doing and thank our banking partners who have adjusted rates downward.

We're on pace to reduce our debt balance by about $350 million in 2019 and we've already paid off $1.2 billion of the $2 billion we borrowed for the merger.

With leases, our quarter end adjusted debt to cap stood at 45%, and we're on track to end the year at about 42% and reach our 40% goal sometime in 2020. We have 100 unencumbered Boeing NGs and Embraer E175s and $400 million of undrawn lines of credit. We've returned $110 million to our owners via the dividend and share repurchases. We set a plan to return $220 million to shareholders this year and we'll hit it, which is a nice way to close. You've heard today a number of examples of where we've set a plan and we're executing on it. The results are encouraging. We're delivering industry-leading operational performance and our customer service is award winning. On the financial side, we have revenue and cost momentum and our balance sheet is strong. And if we continue to execute our plan, we'll be in the top quartile in the industry for profit margins, balance sheet strength and free cash flow generation.

And with that, let's go to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question will come from Savi Syth with Raymond James.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

So a bit of an unfair question because you just delivered -- look to be delivering a really good 2019 on the cost side. But in -- what have you done for me lately, just -- as we think about 2020, I wonder if you can walk through some of the headwinds and tailwinds that you're seeing in 2019? And how they progress through 2020?

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

Hey Savi, it's Brandon. I'll start and then maybe Shane can jump in. That's a super important question as we start to think about the 2020 plan. As I mentioned, we're already wading into that process. We recognize that low costs are a super important competitive advantage that we've had for a long time and will continue to be an important competitive advantage as we go forward. And it's going to be a big part of us getting to our 15 -- 13% to 15% margin goal. A lot of the initiatives that we have in place will provide benefit into 2020. We walked through a bunch of that at Investor Day. I think we've got a lot of momentum, as I said, on that stuff. Shane, you want to...

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

I might only add something, I'll be a little generic. I think the biggest, sort of, specific challenge we have going forward is just all these lease returns, there's a lot of complexity that goes along with that. However, there's a lot of opportunity to do it, to continue to shave costs out of the operation and out of the company, there's tons of stuff we can do on productivity, utilization, all of those things we talked about at Investor Day. We really haven't fully tapped yet. I would say this year is really more about getting the muscle to manage costs back in the next couple of years, as starting to manage those down more aggressively.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

That's helpful. And then on the network side, the unit revenue guidance is really good. I was just wondering if you could talk a little bit about as you understand the network changes and how that's affecting your seasonality, if we should -- and how we should think about -- if this is kind of the -- you're going to have peakier summers here and then 1Q being kind of much weaker, or how we should think about, kind of, the network and how that affects the quarters?

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

Yes. Savi, it's Andrew. I think this comes back to opportunity. And when we acquired Virgin America, it actually made us more peaky. Q1 and Q4 were deeper problems and 2 and 3 were stronger. So what you'll see is, sort of, the traditional pattern. Q2 and 3, very solid, Q1 being the worst. And I think as we move forward as we look at our network for 2020, we are working hard on how we make Q1 much more balanced and much stronger going forward.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

Okay. And not necessarily in place for 1Q '20 but just going forward, is that fair?

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

There's already changes being implemented in the first quarter. And we're going continuing to finalize those. So we're in the process.

Operator

The next question will come from Jamie Baker with JP Morgan.

Jamie Nathaniel Baker - *JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Hey, good afternoon everybody. You've spoken enthusiastically about loyalty in the quarter. I assume that was a consolidated observation, why wouldn't it have been. Would you be willing to discuss loyal returns -- loyalty returns, excuse me, in the Seattle market, specifically. I'm obviously curious if you're losing any share there as your primary competitor pushes its own loyalties scheme. I've got to imagine California, what's really driving aggregate loyalty improvement? But I'm curious if Seattle is declining?

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

Yes. This is Andrew. Thanks for your question. Although we don't normally talk on specifics, what I can tell you without about absolute question is that the Pacific Northwest loyalty continues full steam ahead. Certainly, we have a lower base in California in the percentage -- on a percentage wise increases, they're obviously larger there but actually, all of the things that have being going on has just utterly pushed us to work harder and stronger here in the Pacific Northwest. And we continue to see solid growth in Mileage Plan members and credit cards and revenues in the Pacific Northwest.

Jamie Nathaniel Baker - *JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Excellent. Second question, I know there have been several industry attempts to raise Hawaii fares as a way to -- near as I could tell, they have not succeeded, is that the correct interpretation? Or did we get some fare increases during the quarter? I'm just curious if there's any cause for pricing optimism, given that you're still calling that out -- that market out as challenged, as a RASM headwind in the quarter?

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

Yes. I think for -- on the Hawaii side, there's been marginal attempts at pushing things up a little bit. There's been nothing major at all. I think what really we're facing here is significant seat increases year-over-year in this marketplace. And so -- but we're filling the airplanes. Although at cheaper fares, but again that's one of the assets that we have here with First Class, Premium Class, a new Saver Fare product. All of these things are working to help, in some cases, overcome some of the softness in the fares.

Operator

The next question will come from Duane Pfennigwerth with Evercore ISI.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Given your informal outlook, Brandon, for north of $6 in free cash flow this year, what would you need to see to get more aggressive again on the buyback?

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

Oh, you just did the math based on the numbers I used in the script.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Yes, sir.

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

Okay. Got you. Got you. Here is what I would say is, we've really focused on what we've called re-deleveraging the balance sheet. As I said in my prepared remarks, a fortress balance sheet has really been a hallmark of this company for a long time. Our balance sheet is super, super strong. I think right now, we're really going to keep deploying capital to getting the balance sheet to exactly where we want it, and then think about broader return to shareholders once we get there.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

You've been very clear and consistent on that. And then just for my follow-up, piqued my interest with the Amadeus RM system upgrade, middle of next year. What specific capabilities do you think this will provide for you and is there any, sort of, transition risk around that as you rotate over to that system?

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

No. That's a -- this is Andrew. That's a great question. You realize more about transition risk. We're working off, honestly, 20-year old technology and we've had to design and build a lot of technical reports to manage around that. So this will be next-generation, state-of-the-art. It'll also allow us to do O&D pricing, which, today, we just don't have any capabilities for. And it's also going to be -- allow our analysts and our teams to be much more focused on the macro matters, and that the system will take off a lot of the heavy lifting they're doing at the individual analyst level so we can get better results. So we'll talk to you more about that as we move into 2020. It's an initiative. We have real revenues tied to that. We're not ready to share that yet. And then on the revenue risk, there's always risk but the team has a fantastic plan as they're going to start to layer in markets independent from the systems. So a little bit of an overlap, if you will, and so we're going to do this in a measured, cautious manner so that we don't expose ourself to any real significant revenue risk.

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

Thanks, Andrew. We're not going to go to true O&D pricing out of the gate. We'll go -- we'll stay with -- change vendors but go to segment pricing and then in time we'll move over to (inaudible)

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

Correct. Right. Yes. O&D will be layered on when we're ready to pull the trigger on that, and we'll start with certain regions and we'll turn those on in the new system and then we'll just continue to roll them out.

Operator

The next question is from Catherine O'Brien with Goldman Sachs.

Catherine Maureen O'Brien - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

So just a couple questions on your cost outlook here. First, I just want to clarify. Does your CASM outlook include the signing bonus from your recent contract ratification, meaning you're not including that special item as some of your peers do?

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

Hi, Catie, it's Brandon. Yes, our cost guidance includes the signing bonus.

Catherine Maureen O'Brien - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Great. So then, on my math, the new rates and the signing bonus are about a 90 basis point headwind to your CASM outlook for the year. Signings in your new CASM outlook, including that, is only 10 basis points better than what you were previously forecasting. So I guess what's driving that improvement? And I think, on my math at least, most of that's made up in the June quarter. I know you guys talked about a few things that are trending better than expected. But in the back half, is there an opportunity to see some of that cost strength continue and maybe even trend down despite the new deal?

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

Hey, Catie. It's Shane. Thanks for the question. I'd sort of reiterate what you said and what we said on the prepared remarks that the team did a fantastic job managing costs in Q1 and Q2. I think we may have even surprised ourselves a little bit at how well we managed them. And I think that if we continue to do that, there is opportunity in the back half of the year. There are some costs that we know are shifting. Brandon mentioned those, some of the pilot training costs and a few other areas. But we're still seeing real strength on managing overhead, managing productivity, managing selling expenses as an example. In the quarter, revenues were up 6%, selling expenses were down 3%, which is just a really wonderful result. Usually those correlate together and go up at the same rate. So we're finding areas to marginally improve the company all over the place, and we'll continue to mine that in the second half.

Catherine Maureen O'Brien - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Great. Yes, really impressive because, at least on my math, it's fully offset despite the June quarter better performance there, the new deal. And so then maybe one for Andrew. Does -- we keep hearing about how Saver Fare is trending better than expected, but I don't think we've officially gotten a raise at $100 million annual target. Any comments still waiting for more testing there? Or should we be expecting an uptick there at some point?

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

Catie, I would not hold your breath because we don't plan on giving out specifics and updating that, other than to tell you that the $330 million that we shared we feel very solid about. Saver Fares has actually performed better than we had thought, some others a little less so. But we're just going to stick to the high-level numbers versus going through all the details. But it's doing very, very well for us.

Operator

The next question will come from Rajeev Lalwani with Morgan Stanley.

THOMSON REUTERS

Rajeev Lalwani - *Morgan Stanley, Research Division - Executive Director*

Andrew, a couple of straightforward questions for you. As far as the MAX, what sort of benefit or impact are you seeing there whether it's in your third quarter guide or your second quarter guide? And then your latest read on competitive capacity and how that's trending? And then finally, any color on development markets and maturity there? And whether or not there's much more opportunity ahead of you?

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

Yes. Thanks. The best way for me to talk about the MAX is just to really look at the industry seats and what we're dealing with. And as is very public knowledge, we saw a number of closer-in pull downs by carriers to accommodate the MAX. So we've sort of been a recipient of that. If you look forward though, our competitive capacity on a weighted basis is actually down 0.7% in the third quarter. And again, I think that's in no small part to the industry capacity coming down, which I think brings good things for everybody when capacity discipline is carried out that way. The other thing I would tell you is that on the new markets and the maturity, we still have -- we've seen really good improvement. Some -- we're on average I think up to about 85% of normalized yield, and they continue to improve. And a little bit -- some of the California markets, especially so. So there is still upside for us as we continue to mature these markets.

Rajeev Lalwani - *Morgan Stanley, Research Division - Executive Director*

Can you quantify maybe that last one, I mean, how much you've seen so far or how much more there is to go?

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

As it relates to the guide, no. What I think -- what we continue to want to see in our developing markets, which were a much smaller percentage of our network now, but we still want to see high single to double-digit unit revenue increases in those markets. But I don't have a dollar figure or a RASM number to quantify that for you.

Operator

The next question is from Helane Becker with Cowen.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So I had two questions. My first question is related to Love Field and what are you doing there? And will you not be serving that market anymore? Is that the way to think about it?

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

Hi, Helane. This is Andrew. No, we are absolutely serving Love Field. I think what's got a little confusing on all of that is that, we have -- as you know, there's a lawsuit going on. I'll let Kyle touch on that in a second. But we have 2 gates there. There's a lawsuit going on. And we have 13 flights a day. What we've done is there is uncertainty around how that lawsuit's going to end up and what's happening. So we had scheduled more flights. So what we're doing is holding to our 13 flights a day. What we're doing is concentrating now on 4 markets, which is Seattle, Portland, San Francisco and Los Angeles. And that's sort of what we're going to be flying here for the foreseeable future. But Kyle, did you want to comment?

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

Sure. Hi, Helane. Ya, the litigation really just plods on. It's scheduled to go to trial in September. We'll see if that sticks or not. In the meantime, the judge has been very active in keeping up settlement discussions among the carriers and the city. And I'm afraid to say, there's so far not been much progress there although people are talking.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Okay. And then my second question was on transcon. So I think in the first quarter, that was a kind of a problem. And I didn't hear you mention whether that was improved in the second quarter and how that looks for the summer?

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

Thanks, Helane. Yes, it was a real problem in the first quarter. And in my prepared remarks and just what we've been sharing, as we are very, very encouraged with what's happened there. We have significant unit revenue increases in those during the second quarter as pricing stabilized. That's continued into the third. And we have seen double-digit margin increases in those transcon routes. And in part -- notable part, that our employees have really rallied around those markets, around the guest service, both in the aircraft, on the ground, we're making sure the satellite flights get on there, our SOC has done a magnificent job getting to 99.5% completion rate. So we are just all in focusing on the guest experience, and it's making a difference.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Okay. And then could I just follow that up with one MAX question? Would you consider keeping A320s to backfill the MAX?

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

Helane, it's Brandon. I'll take that one. We have 3 A319/320 airplanes that are due to be returned between now and the end of 2020, and we're going to stick with that for the time being. Those are already in process to one degree or another. We do have MAXs coming in next year. Our MAX exposure was pretty darn small. We were supposed to get 3 in the last few months of this year. It's perhaps 1 now. Those 2 that we are -- we're not going to get this year will probably come. If things play out like we're hearing, they might play out in the first quarter. So the capacity issue for us isn't nearly as acute as it is for some other MAX operators.

Operator

The next question is from Michael Linenberg with Deutsche Bank.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Andrew, you called out the improvement in pricing. You indicated it stabilized and improved through the quarter. Could you just give us maybe some additional color to show how things trended? And then is that continuing -- that trajectory continuing into the third quarter?

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

Yes. I think really around the pricing environment I would say it's -- our biggest problem was, obviously, close in fares and business fares where we're very, very low during the first quarter. So those have substantially gone away and have stabilized. The fare environment, I would say, in a number of areas, are still sort of down a little bit year-over-year but stable. And again, the way we've overcome that, of course, is with all these new revenue initiatives and a lot of the changes we're making to the business. So for me personally, the way I would describe the fare environment for

Alaska is one of stability, and we're working with that. And we're not seeing any real changes in demand. And demand continues, actually, to be quite robust.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Okay. Great. And then just a second question, and Andrew, this is to you as well. I realized it's early with the Paine Field operation, but how has the startup been? And when you look at the clientele, are these passengers who formerly flew out of Seattle? Are they new customers maybe coming from other carriers? What can you make of the Paine Field startup? Just curious about how it's going.

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

That's -- I don't -- well, starting what we did in Paine with 8 new markets and starting off with 18 frequencies has been quite amazing. Other than Portland to Seattle, we probably got a little too much -- excuse me, Paine, Portland we've got probably a little too much capacity there but on the whole, all of these markets are well into our average load factors now. And the yield is working its way up and I think we couldn't be more impressed and excited with how the start up of that operation only after 3 months has gone. I will say that we've probably seen a lot of non-frequent fliers actually flying out of Paine Field. My initial guess would be a lot of our customers will and they are. Some habits are hard to break but what's really exciting is we're seeing a lot of non-core loyalty members taking advantage of the close location of Paine Field and demand has been very, very good.

Operator

The next question is from Hunter Keay with Wolfe Research.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense*

Appreciate you guys not playing out the signing bonuses special item. That's really good stuff. It's noticed. I do have a question for you on the selling expenses. I don't know if this is Shane or Brandon. How is it down so much? I know that some of that's accounting reclassification, but even if you take that away adjusted it's still down by tens of millions of dollars the last couple of years. Is this something you renegotiated with Virgin? What are you doing to get that down? How much more is there to go?

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

This is Shane. Yes, you pretty much know that we did get an opportunity to renegotiate a lot of deals that Virgin had that got closer to our rates. In a lot of those cases, we were able to actually bring our rates down at the same time. So that stuff that has taken place over the last year or 2, it includes not only the cost of distributing tickets through travel agencies and GDSs and medic partners but also our core passenger service systems. We've basically renegotiated all of those in the last 3 years at really attractive rates for the company.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense*

Oh, so there is such thing as a merger synergy then?

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

There you go.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense*

Okay. Good. And this is a little bit more of a high-level question. But I don't know if you've noticed but the markets of Hawaii has changed a lot over the last 10 years. And there's a lot more sort of long-haul narrowbody flying with neos and, for a time, MAXs where there's more outer island destinations being served from smaller communities that was not previously really able to do without these neo technology and MAX technology. I feel we're starting to see that a little bit in Alaska. You mentioned some overfly of Seattle. You're seeing American put, for example, a 321neo out of Phoenix into Anchorage. Are you prepared for this? How are you thinking about overfly being a permanent issue as more airlines get the neos? And are you prepared to sort of cannibalize your own connecting traffic with the MAXs, if you need to do that, sort of like Hawaiian is doing with their neos?

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

Yes. I do, Hunter. It's actually -- your observation is spot on. I think the way that we look at it is the opportunity for others is the same equal opportunity for us. I mean we fly all of those East Coast destinations from Seattle. We have a strong, obviously, network actually in the State of Alaska including strong feed. We fly Anchorage-Chicago. So I think a couple of things. I think there could be opportunity for us going forward given the aircraft type to do some of that ourself. There will be occasions where there's true overfly and traffic that we may have challenges getting. But at the end of the day, we have a very, very strong network up there, a very, very strong loyalty proposition and we will continue to fly where Alaskans need to go on a nonstop basis and as we go forward.

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

Yes. Hunter, something like 2 out of 3 in Alaskans are members of our mileage plan. And I would agree with Andrew, if there is a desire for more longer-distance flying into Alaska hubs, we should be competing for that. The other thing I would just note is -- just the relationship between the economies in the state of Alaska and in Seattle in particular is extraordinarily composed, whether it's government, or fishing, or timber, or whatever it -- tourism, whatever industry we might be talking about. A lot of those business connections are here. If someone does want to go to Houston for oil or something like that, that's a customer that we are going to have to compete for if they're doing longer distance flight. But I think a lot of it actually is Seattle business.

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

And a lot of it's just really -- just been in the peak summer season as well.

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

That's exactly right.

Operator

The next question is from Joseph DeNardi with Stifel.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Andrew, just on RASM performance in 2Q, up about 5%, 3.5 points or so from the initiative. So 1% increase in capacity led to maybe a 1.5 point increase in core PRASM, if you want to call it that. Like why is that a good result? Why isn't there more traction in PRASM given your kind of modest capacity growth?

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

I mean the way -- the simplistic way I look at this is, firstly, what we've committed to is, number one, we want to grow unit revenues in line with the industry. And the industry also has initiatives and revenue initiatives in there. And if you look at our revenue and synergies, that's about 400 basis points. So what we're really saying is we're going to grow at the rate the industry is that includes their initiatives plus another 200 basis points on top of that. So that's how we're thinking. We think that's a very strong result. I'll also think our stage length increased by about 1.5% during the second quarter, which also puts downward pressure on unit revenues. And we're also seeing significant increase in stage length even in the regional business as well, as their mix gets more, a little bit long haul. So overall, and then last thing I will just point to is our margin. We have close to 16% margin for the second quarter. And we have powder left in both our cost and revenues. So overall, what you're seeing is a track that we're headed to at 13% to 15% margins. And so you're right, it can be better and it will be better as we continue to move this thing forward.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Okay. And then Andrew, I guess I was a little bit surprised given how important revenue generation is to an airline business that you're using 20-year old technology, I would have thought that was upgraded a little bit more frequently. So why is that? And what is the revenue opportunity from that?

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

So again, we have a system. And again, it's just all about priorities and I think when we acquired Virgin America, much of what we're looking here massive step change in the size and complexity of our business. So we definitely -- it's time for a new system. We will be sharing with you as part of our outlook for 2020 what our revenue initiatives will be including the revenues there. So we're not prepared to speak to those today.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

And is it material?

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

It's -- yes, it is.

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

Andrew, we have a top-notch revenue management leadership, analysts, and when you have a top-notch commercial analytics team that makes up maybe a little bit for us upgrading the system as quickly as we may want. --

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

The vendor we're with now, it's not like they haven't updated the software but it is -- it's a new platform that we're moving to.

Operator

Kevin Crissey with Citigroup.

Kevin William Crissey - *Citigroup Inc, Research Division - Director and Senior Analyst*

And I just continue on with Amadeus quickly. Why choose Amadeus? My understanding is that the best aspect of that is the international component. Does that suggest maybe a more of an international focus going forward? Or was there some other reason for that vendor selection?

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

Yes. Without going into details, we did a very thorough RFP looking at all the vendors. And it came down to cost, it came down to capabilities, it came down to what our RM team needed and wanted for our network today and our future networks. So that was the decision.

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

But to be clear, I don't think new international service, I don't think that was a big driver.

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

Not long-haul service. No.

Operator

The next question will come from Brandon Oglenski with Barclays.

Matthew Aaron Wisniewski - *Barclays Bank PLC, Research Division - Research Analyst*

This is actually Matt on -- Matt Wisniewski on for Brandon. So I know it's early for 2020. But as growth starts to ramp and next year return to growth, I was wondering if you could share any kind of attributes on what the priorities for growth are? And what -- how we should be looking at that? And then as a secondary, in the context of a 4% to 6% growth, how much flexibility would there potentially be in that, specifically in the context of the margin targets?

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

Matt, it's Brad. I might jump in here. I think the first priority -- we've got just an incredible economic engine in the Pacific Northwest. So the first priority would be feeding that engine and doing everything we need to do to sort of defend and grow markets out of the State of Washington, the State of Alaska, the State of Oregon. I think the second priority, we've got some important new geography in the State of California, in San Francisco and LAX, in particular. I think it would be doing the flying that we need to do in those markets to provide just the important base utility for business travelers and others in those markets. And I think after that, I think there are, and Andrew sort of answered at this. There's opportunities for us to do a better job of connecting the different parts of our network in strategic ways, and so I think that would be the third priority. Finally, we've always got an opportunity to make sure our -- when we have multiple frequencies in a city pair to make sure those flights are well-timed, to make sure that if we're flying back and forth from the West Coast to the middle of the country, that our times are friendly to West Coast customers. So those are -- in my own mind, those are sort of -- that would be sort of a top to bottom sort of priority about how we would think about future growth. Might be off the line. How...

Operator

The final question is from Dan Mckenzie with Buckingham Research Group.

Daniel J. Mckenzie - *The Buckingham Research Group Incorporated - Research Analyst*

An Amadeus question as well. Presumably that gives you more merchandising capability versus what you have today, is that a fair characterization?

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

Dan, it's Shane. I'll just take this because I happen to be the person who installed the merchandising system. We actually have one. We use Farelogix today. Amadeus has a really good one as well. We were super happy with our partnership with Farelogix right now. But if there was an opportunity to move to Amadeus, we could do that. But we've a really good, robust merchandising platform today.

Daniel J. Mckenzie - *The Buckingham Research Group Incorporated - Research Analyst*

Got it. Okay. Another sort of technical question here. With respect to the increased premium seats coming from the reseating on the Airbus, can you ever revenue manage these seats realtime as they come online? Or is there some conservatism on that until you reach a critical mass, either in terms of aircraft or as you think about the planes?

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

Dan, this is Shane again. I launched PCs, so I guess I'll take this one too. The only real conservatism is making sure that if we sell the seat, the PC seat shows up. As you know, we don't really assign a specific shell to a market until we're closer in. So trying to sell a seat 6 months ahead when we actually assigned the aircraft, that's always -- that's the calculus we try to go through. So there's a little bit of a ramp up here as we've come online. But it doesn't take that long for us to be able to pre-sell through the entire window.

Daniel J. Mckenzie - *The Buckingham Research Group Incorporated - Research Analyst*

Got it. So when a new aircraft comes on, these premium seats maybe don't sell at a premium for like the first month or how would you characterize the lag?

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

Yes. The way we do it -- just not to get too technical. If we have like 20 planes coming in, and we might sell 10 planes worth for about a quarter. And then the next quarter, we'd sell 15 planes worth. The next quarter, we sell 20 planes. So it may take 2 or 3 quarters to burn in.

Daniel J. Mckenzie - *The Buckingham Research Group Incorporated - Research Analyst*

Got it. Okay. And one final question here. Wondering if you could talk the Airbnb restrictions that were recently passed in Hawaii. How are you thinking that might or might not impact travel to or demand to Hawaii?

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

Yes. I think we, like everyone who are watching now, I think my understanding is about 5,000 units of inventory coming offline for Oahu only. It may result in people flying to the other islands for a better availability and costs. And we fly to all of those 4 islands. But again, that's something Kyle will be watching overtime. Our bigger focus, obviously, is how many seats are going into Hawaii because at the end of the day, Hawaii is about supply and demand.

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

Okay. I think we're not going to hear from the operator again. Thanks, everybody for tuning in today for our second quarter call. We look forward to speaking with you all again in 90 days time. Thank you.

Operator

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