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OVERVIEW:

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Alaska Air Group 2023 Fourth Quarter Earnings Call. (Operator Instructions) Today's call is being recorded and will be accessible for future playback at alaskaair.com. (Operator Instructions) I would now like to turn the call over to Alaska Air Group's Vice President of Finance, Planning and Investor Relations, Ryan St. John.

Ryan St. John - *Alaska Airlines, Inc. - VP of Finance, Planning, & IR*

Thank you, operator, and good morning. Thank you for joining us for our Fourth Quarter 2023 Earnings Call. This morning, we issued our earnings release along with several accompanying slides detailing our results, which are available at investor.alaskaair.com. On today's call, you'll hear updates from Ben, Andrew and Shane. Several others of our management team are also on the line to answer your questions during the Q&A portion of the call.

This morning, Air Group reported a fourth quarter GAAP net loss of $2 million. Excluding special items and mark-to-market fuel hedge adjustments, Air Group reported adjusted net income of $38 million. As a reminder, our comments today include forward-looking statements about future performance, which may differ materially from our actual results. Information on risk factors that could affect our business can be found within our SEC filings.

We will also refer to certain non-GAAP financial measures such as adjusted earnings and unit costs, 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. Over to you, Ben.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Thanks, Ryan, and good morning, everyone. Alaska Airlines closed out another great year in 2023. Before we get to those results, I want to address the recent grounding of our 737 MAX 9 fleet. I am deeply sorry to everyone on board Flight 1282 for what they experienced on January 5 and to all of those who have seen their travel plans disrupted by cancellations.

We are looking forward to returning to the reliable service you know and expect from us. Our #1 value and our absolute priority is and will always be safety. As you may know, following the accident, we proactively grounded our 65 MAX 9 aircraft, which was followed by a directive by the FAA to do so for all U.S.-based operators of the fleet. This had a material operational and financial impact on our business with approximately 1/3 of our January capacity impacted by the grounding.

Additionally, we believe it is likely that several aircraft deliveries could be delayed which would further affect our full year capacity plans, which we initially anticipated would be between 3% and 5% over 2023 levels. Our primary focus right now is the safety of our guests, our people, and our fleet. We remain committed to working diligently alongside the NTSB, FAA and Boeing to return our aircraft safely to service and ensure this never happens again.

As a longtime valued partner, we remain fully committed to our relationship with Boeing, but we also intend to hold them accountable. There is work to be done but we have the utmost confidence with FAA oversight as well as our own that Boeing will emerge with improved quality processes as a better and safer manufacturer.

I also want to take a moment to thank our employees for their response to this event and its aftermath. Safety and care are at the heart of everything we do, and our people continue to demonstrate the highest standards of professionalism and caring for our guests and each other. It has been a long and difficult few years since 2020, and I continue to be amazed at this resilient team of employees, rallying to meet any challenges put in front of us. They demonstrate the Alaska Spirit each and every day.

Now let's turn to our results. As I consider 2023 in its totality, I am proud of our company's accomplishments over the year. We competed for the industry's best margin, and were close to achieving this goal in 2023. Had it not been for surging international demand and a 1.5 point margin impact from higher West Coast fuel refining costs, both of which I believe are transitory impacts to our business, we would have once again posted the highest margin in the industry.

Given our strong year of performance, I'm proud to announce that our people will receive another great bonus as we will pay out approximately $200 million, or on average 6.4% of an employee's salary. This is the fourteenth time in the past 15 years that we paid above target for our performance-based pay program.

Our cost execution was unmatched as we delivered the best CASMex result in the industry, down 2.6% year-over-year. This result was at the better end of our originally guided range first communicated in December of 2022. It's worth noting that throughout the course of the year, the majority of the industry revised cost guides higher while we did not.

It proves to me our cost discipline DNA remains well embedded in the company's culture, and we will continue to, over the long term, have a durable competitive advantage over peers in this critical area of the business.

We ran an excellent operation as we prioritized reliability in 2023, hitting record completion rates throughout the summer. We ended the year with a 99.3% completion rate even as we finally surpassed pre-pandemic levels of flying and managed the successful transition out of our Airbus fleet.

Our process-driven operational playbook works. We delivered the premium experience our guests have come to expect, and we have every expectation to continue to be a best-in-class operator in 2024 once our 9 MAX fleet returns to service.

Our balance sheet remains one of the strongest in the industry with net leverage below our long-term target of 1.5x for the second year in a row. We restarted share repurchases in 2023 reaching $145 million or 3.5 million shares which is nearly 2x annual dilution.

Our strong balance sheet has provided the foundation for our growth and expansion over the years, including pursuing our proposed acquisition of Hawaiian Airlines. And as a quick update, we initiated the process of obtaining antitrust clearance by submitting our HSR filing this month. We've held initial conversations with the DOJ and the process will continue. We believe we have a stronger and differentiated case from JetBlue and Spirit and look forward to providing updates as they become available.

Lastly, we generated a record $10.4 billion in revenue, 46% of which comes from our premium, loyalty, and ancillary revenues. We brought in $1.6 billion in cash from our loyalty program and added 5 new global partners bringing our total partner portfolio to 30. Much of the hard work we put into 2023 will carry into 2024. Our priorities remain focused on: one, on yielding safety and investing in our people and culture; two, elevating our commercial initiatives to deliver a premium brand experience as the only domestic-oriented carrier with a comprehensive offering; and three, maintaining a competitive cost structure. The combination of which we know provides the foundation to drive durable financial performance.

2024 has begun under very difficult circumstances but we are optimistic about what we can accomplish this year. Absent the grounding event, we were heading for a significantly improved first quarter result versus 2023. As I stated in April of last year, we are committed to returning to breakeven or better results in the first quarter, and I believe we've made tangible progress toward that goal. Last year, we lost $115 million in this period, and we were on track to drive a 30% improvement this year as the network changes we made began taking effect.

As it has been for years, our goal is to concentrate our efforts on building preference for our airline through a premium experience and a fundamentally sound business model that endures over the long run. One that is resilient through cycles and creates durable financial returns for all our stakeholders. We made great progress in 2023, and we are well positioned to do much more in 2024. And with that, I'll turn it over to Andrew.

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

Thanks, Ben, and good morning, everyone. Today, my comments will focus on fourth quarter and full year results, along with Q1 revenue trends. Fourth quarter revenues reached $2.6 billion, up nearly 3% year-over-year, coming in slightly ahead of the midpoint of the revised guidance we put out in early December. Capacity finished the quarter up 13.6%. We saw a strong finish to the year in December with limited weather events and excellent operational performance to support holiday travel. This resulted in record traffic and coupon revenue up 7%.

For the full year, we generated a record $10.4 billion in revenue, this was up 8.1% versus 2022 on capacity of 12.8%, resulting in full year unit revenue down approximately 4%. The improvement we saw in unit revenue through year-end showed a marked strengthening in our core revenue. Unit revenues improved from down 13% in August to down 9% in December. Notwithstanding we grew December capacity 2 points more than August year-over-year. This is a 4-point improvement, underscoring a strengthening pricing environment from continued normalization of international demand and industry adaptation to post-COVID demand realities.

On managed business travel, consistent with what we've shared before, our belief is that we're seeing a slow and steady recovery.

For example, in the fourth quarter, our portfolio saw a strong 15% year-over-year revenue growth on higher volumes and yields. Overall, business revenues are within 5% of 2019 levels with most industries now fully recovered. The notable exceptions are tech and professional services, which still lag other industries but did see 26% and 14% year-over-year revenue growth, respectively, in Q4.

Premium cabin revenues also continued their solid performance in 2023. First and premium class revenues finished up 15% and 10%, respectively, for the year, continuing to substantially outpace main cabin revenue. At nearly 32% of total revenue our premium product orientation provides a clear point of differentiation against our domestic focused peers, which will continue to be a core competitive advantage for us in years to come.

Regarding loyalty, bank cash remuneration also hit a new record, bringing in $1.6 billion for the full year, up approximately 13% year-over-year.

We also continue to thoughtfully build value in our loyalty programs through our extensive portfolio of domestic and international partnerships and alliances, which represent approximately 7% of our total revenue. In 2023, we added 5 new partners, bringing our total airline partnerships to 30, 21 of which we now sell on alaskaair.com.

Our pivot to selling partners on alaskaair.com, we believe, will be a big unlock for us. We expect to further build out our selling platform in 2024, including a significant add in British Airways who we have never sold direct from our website other than for award redemptions. Selling our partners direct has 3 significant benefits. First, our website becomes increasingly valuable as a one-stop shop, providing a step change in utility for guests through expanded booking options for both domestic and international trips.

Second, it further rewards guest loyalty. When our guests book itineraries on our partners through alaskaair.com, they benefit from Alaska's generous policies, such as no change fees, and importantly, full mileage accrual for main cabin and above on all partners we sell directly, which is not available through other channels.

And third, it drives incremental revenue to Alaska. In December, 38% of partner revenues sold on alaskaair.com was attributable to an Alaska operated segment. In 2024, we plan to sell approximately 5,000 tickets per day on partner flights, which is double what we sold in 2023. As we grow partner sales on alaskaair.com, we will also improve our own operated revenues.

Now turning to our outlook and guidance. Assuming a gradual return of service of the MAX 9 fleet through the first week of February, we expect to have canceled over 3,000 flights during January, impacting our first quarter capacity by 7 points which will result in capacity being down mid-single digits year-over-year for the quarter.

However, given the time of year is seasonally low from a demand standpoint, we've been able to rebook over half of those guests impacted by cancellations back onto Alaska flights. Additionally, capacity flexibility at our regional carrier, Horizon, due to lower pilot attrition has resulted in their operation of more than 150 unscheduled flights. This has allowed us to rebook over 10,000 impacted guests and get them to their destinations.

As Ben mentioned, we were on an excellent revenue trajectory for the first quarter.

Prior to the MAX 9 grounding, we had line of sight to unit revenues up 1% to 2% year-over-year on low single-digit growth with held yields improving 1 to 2 points per week to start the year. This is a significant 11-point change in trajectory in unit revenue performance from Q4 of '23. As we sit here today, held yield for February and March is marginally positive with daily sold yield up 8% this past week.

Clearly, we are seeing the benefits from capacity adjustments to new post COVID demand realities, strategically reshaping our network and applying our learnings to utilize our assets more optimally. We are seeing strong unit revenue performance from bookings in our highest frequency business markets and intra-California, where we reduced capacity double digits year-over-year. Several new leisure markets are also performing well right out of the gate. And then lastly, the general fare environment is improving along with the competitive capacity backdrop in our markets.

For the past 6 months, competitive capacity was up high single digits, but trending towards flat in Q1, ahead of low single-digit growth in the second quarter. At this point in time, our held load factors for Q1 are near flat and daily intakes remain positive on a yield basis year-over-year. Taken all together, absent the impact from the MAX 9 grounding, we feel very good about the outlook for our core business in Q1 and beyond.

And in closing, we are now a $10 billion revenue franchise, and are not the same company we were a few years ago. We have a diversified product mix and all the elements in place to cater to evolving guest preferences, including lounges, first and premium class across 100% of our fleet, a global network through our partners and a robust loyalty program. Yet there is more to come, and we are excited to continue building on future opportunities, optimizing premium seeding upsells, implementation of NDC and better merchandising and increasing the number of premium seats on both our Boeing 8s and 9s, all of which will help support strong financial performance and long-term profitable growth. And with that, I'll pass it over to Shane.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Thanks, Andrew, and good morning, everyone. Before I discuss our fourth quarter and full year results and provide additional information on the impact of the MAX 9 grounding, I will reiterate that safety is and will remain the #1 priority for Alaska. Our results are secondary to that concern and we will always place safety considerations for our people and our guests above financial performance.

For the fourth quarter, our adjusted EPS was $0.30 on an adjusted pretax margin of 2.2% which was above both our initial and our most recent guide for the quarter. Unit costs ended down 6.7% versus 2023, while economic fuel cost per gallon was $3.42. Our fuel costs remained disproportionately impacted by elevated refining margins on the West Coast relative to the rest of the country. As a reminder, in the third quarter our refining margin costs were $0.30 higher than U.S. Gulf Coast margins. That spread held most of the fourth quarter where West Coast refining margins were $0.34 higher.

We did see improvement late in the fourth quarter and into the first and today, we are back within $0.10 of U.S. Gulf Coast. This phenomenon, although we believe temporary, has been material to our results. Our full year pretax profitability would have been 1.5 points better had refining margins behaved more normally.

Our adjusted EPS for the full year was $4.53 and our adjusted pretax margin was 7.5%. Unit costs were down 2.6%, while economic fuel cost per gallon for the full year was $3.21.

As Ben mentioned in his opening remarks, the strength of our balance sheet remains intact. Our leverage levels closed the year within our long-term target ranges at 46% debt to cap and 1.4x net debt to EBITDAR. And during the quarter, we received an investment-grade credit rating from Moody's. We generated approximately $1.1 billion in cash flow from operations during the year, while total liquidity inclusive of on-hand cash and undrawn lines of credit stood at a healthy $2.3 billion.

Debt payments for the quarter were approximately $40 million and are expected to be $100 million in the first quarter. We more than offset dilution this year with $145 million in share repurchases. With over $300 million still existing under our current share repurchase program, we intend to continue once again to at least offset dilution in 2024.

Moving to costs, the teams have performed well during the year with continued improvement through the second half and December quarter. Fourth quarter CASMex ended well below our guide at down 6.7% as we continue to execute and outperform against cost targets while milder winter weather helped strong completion rates and ASM production to finish the year. Even more notable, our full year CASMex ended down 2.6%, better than our latest guide of down 1% to 2% and at the better end of our original guide of down 1% to 3%. Even adjusting for higher capacity, we were within $32 million of our original midpoint on a nonfuel cost base of $7 billion.

We achieved this result amidst ramping our operation back to and beyond pre-pandemic flying levels, doing so at a record completion rates and while absorbing significant wage increases. I believe our cost management was clearly differentiated versus the industry in 2023 and provides confidence that we will continue to maintain our relative costs versus our competitors in the years ahead, even as cost inflation has been a clear reality of the industry recently.

The benefits from our upgauging strategy were also clear. We grew full year capacity 12.8% on only 2.5% departure growth and improved fuel efficiency measured in ASMs per gallon, nearly 4%. Attention to cost at detail matters to us at Alaska, and we will continue to work on improving efficiencies within the context of lower growth and remaining cost headwinds in 2024. Given the impacts of the fleet grounding, we are opting to provide full year EPS guidance only. We also like the idea of shifting focus to margins and cash flow versus unit metrics.

We expect our full year earnings per share to be $3 to $5, which assumes a $150 million negative impact from the fleet grounding. While we fully expect to be made whole for the profit impact of the grounding, we do not have details to share today on that process, nor have we incorporated this into our guidance. Excluding the approximate $150 million impact, at the midpoint, our EPS guide implies a flat to slightly improved result in 2024 versus 2023.

We expect our full year capacity to come in at or below the lower end of what had been our original expectation to grow 3% to 5% versus 2023. Our fleet plan called for 23 mainline deliveries this year, 16 MAX 9 and 7 MAX 8s. We anticipate some of these deliveries may be delayed, hence, the inability to provide more precision on year-over-year growth.

Lastly on costs, this lower growth rate coupled with strong 2023 cost performance results in a tougher comparison baseline for 2024. There are remaining cost headwinds the entire industry is facing in 2024 and we do not believe we will be disproportionately impacted by them.

Wages are a large portion of this. We will be lapping the pilot wage step-up implemented in September, which is approximately $90 million for the full year and $60 million incrementally in 2024. We have an agreement in principle with our technicians, and we're hopeful for a tentative agreement soon. And we have resumed negotiations with our flight attendants and are anxious to reach a TA with them as well.

As we look forward, our outlook and priorities remain unchanged. We will prioritize a strong operation, continue to focus on managing costs and recovering prepandemic productivity, ensure we are deploying our network in a way that is responsive to demand in the market and will continue to drive our commercial road map and emphasize the competitiveness of our premium product offerings.

We have a business model configured to compete with anyone in the industry and are optimistic about our ability to continue to deliver on our goal of delivering the industry's best margins. And with that, let's go to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today will come from Ravi Shanker with Morgan Stanley.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

So obviously, a noisier start of the year than you expected, and I don't think anyone can really blame you for this. But can you share anything you've seen in terms of brand damage or NPS promoter scores that may be impacted by this? And also kind of what you're seeing in the forward booking curve in terms of any kind of MAX lingering issues there?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Ravi, it's Ben. What I can say is, I've been overwhelmed with the support of our customers. And I think it's just a tribute to our employees who've done so well in gaining loyalty over the years. And they can't wait for us to get back to full service and our anticipation is when our MAX 9s get back up, we will fill our airplanes.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

And just maybe as a quick follow-up. You said you're looking to hold Boeing accountable and don't have any info to share there. Any idea kind of when you might have something to share there?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Well, Ravi, as you know, my first priority is to get our MAX 9 fleet back into service and get our schedule back up to 100%. So that's priority number one. We'll work on the accountability with Boeing. The accountability is essentially on raising the quality standards at the factory as well as making us whole. But that will be secondary. Right now, we're focused on safety and quality and getting our fleet back to a full schedule.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Very good. Good luck and good job everyone.

Operator

Your next question will come from Savi Syth with Raymond James Financial.

Savanthi Nipunika Prelis-Syth - *Raymond James Ltd., Research Division - MD*

Just to kind of follow up on Ravi's kind of questioning especially as you kind of think of your deliveries this year and maybe kind of next year as well. Just any thoughts on -- or maybe what is your kind of 2024 outlook kind of based on in terms of deliveries?

Has that changed at all? And just any kind of views on CapEx here going forward? I know you gave a guide for FY '24.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Savi, it's Shane. Thanks for the question. I wish we had more detail. We don't. It's just so early in understanding the impact. As Ben mentioned, the real focus is getting the MAX 9 fleet that's grounded back flying the schedule safely. We have started to think about the fleet plan going forward, we were meant to take 23 aircraft this year, 16 MAX 9s and 7 MAX 8s.

And our suspicion is many of those will get delayed, but we don't know for how long. What I can tell you is we have enough aircraft to fly the schedule we're selling today, and we'll be very careful to make sure that we've got enough fleet to fly what we're out there selling. I think we -- in December, I mentioned $1.4 billion to $1.5 billion of CapEx down from last year. I think it's not going to be more than that.

My suspicion is it will be less. And as that becomes more clear, we'll provide updates either at the next call or by an 8-K mid-quarter.

Savanthi Nipunika Prelis-Syth - *Raymond James Ltd., Research Division - MD*

Makes sense. And just a comment on the cost front. Just curious if you could kind of talk about it as we think through the year, if there are any kind of comp views or some headwinds that are greater kind of in any part of the quarters as we go through the year.

And also was just curious if you have any kind of labor contracts that you might be negotiating currently kind of with -- considered in that guide?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Savi. Like I -- we didn't put a cost guide out. I think it's hard to predict Q1. We obviously have lost a significant number of the ASMs we wanted to carry in Q1 and less material to the full year, but not knowing what the delivery stream is going to look like, I think we're going to have a much lower growth rate than we had initially thought. We haven't managed costs out of the system for that today.

And we still need to decide sort of how to size the company given what we ultimately decide to grow. I think for 2024, what we're facing are similar cost pressures that you've heard from others, there's certainly annualization of pilot wage costs. And as I said in the script, we are very anxious to get ratified agreements with both our technicians, which we're close, I hope to getting the TA with them - we have an agreement in principle - and with our flight attendants.

We need to get both of those done. And then airport costs and maintenance costs, which are very similar to competitors, there's pressure throughout the year on those. I think what I would also just mention is when it all washes out, our cost structure is going to be as competitive relative to legacy peers and I think more competitive relative to the rest of the industry, as we go through this year and close out this year.

So even though the unit cost might be pressured because of the growth rate, I think our core cost structure is going to be in a better position relative to everybody else once we close 2024 out.

Operator

And we'll move next to Scott Group with Wolfe Research.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Analyst*

So I was wondering the $150 million that you guys cited, is there any is there any -- is that inclusive of any book away impact? Are you seeing that? And then I just want to be sure. So when you talk about capacity down mid-single digits now in Q1, but you've sort of rebooked half of the lost stuff like does that imply that RASM is actually going to be better than the 1% to 2% than you were initially planning for? I just want to understand just the moving pieces for the model. For Q1.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Yes. Scott. The $150 million is really tickets that we've had to cancel and essentially refund, we couldn't rebook. There's some costs of buying tickets on other airlines to reaccommodate. There certainly some costs in that number for over time and just the operational stress that we've had to go through. There's no like long-term core book away we think. We're going to be still able to have a very strong spring break and mid-winter break season.

As Ben mentioned, we've been hearing from our guests, they can't wait to have the fleet flying again and come back and fly with us. There's certainly some close-in revenue loss that's in the next few weeks from business and even leisure just because it's so close to travel that we probably won't get to pick back up. And so there's a small portion that you could call book away just over the next few weeks, but I don't think there's a brand related, we don't expect a brand-related long-term impact, if we see one, obviously, we'll talk about that. But right now, I think we expect our guests to come back to us.

Capacity down mid-single digits. Yes, I think, look, unit revenues the point Andrew was making is we were on a really good trajectory. We felt great about the network reshaping that his team has done. We felt great about advances into the first quarter. The fact that we're losing a bunch of revenue in the first quarter, we're also losing a lot of ASMs. So I think the revenues could still be positive as we close the quarter out once that all nets out.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Analyst*

Okay. Helpful. And then I'm just curious, how does the JetBlue Spirit ruling change your views on success of approval with Hawaiian? And just any thoughts or color on just when you go through the Hawaiian proxy, some of the cash burn there, if that's all sort of incorporated in everything you laid out for us when we did the announcement.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Yes, Scott, thank you. It's Ben. Our view is that these deals are completely different. The JetBlue Spirit was blocked by the judge essentially because it would eliminate a low-cost competitor. In our case, between Hawaiian and Alaska, these are 2 very similar business models. The networks are very, very complementary. In fact, when you combine the networks, there's only 12 overlap routes through the combination.

So it's very pro consumer, and it's also very pro-competitive. Customers in Hawaii will have an expansive network to fly to the United States and internationally, our customers on the West Coast will have more options to fly to Hawaii and international. So it's very different from the JetBlue Spirit. And look, after the deal would become a little bit larger airline to compete stronger against the network carriers and now we have a strong domestic network with a strong international network. So we feel our case is differentiated, and we'll work through the DOJ on that process.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

And Scott, I'll just mention very quick on Hawaiian cash burn since you also asked about that. It's -- in everything we've laid out, the cash burn is really principally tied to the delivery stream. And I just note that there's an asset behind that that has value that we want.

And so we're not funding significant or material operating cash losses. The negative cash flow is really about the CapEx right now. And we think that, that business is going to recover over the next couple of years as Asia comes back and as they get Amazon up and the 787 up and Maui recovers.

Operator

Your next question comes from Duane Pfennigwerth with Evercore ISI.

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

I guess other than the lost ASMs from flight cancellations. Can you just talk a little bit more about maybe deliveries that you think could shift? Or what other pieces there are that could influence where you ultimately end up for the year?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Yes, Duane, on capacity, I really think it's at this point, the deliveries. I think given the guidance we got yesterday, we have a good sense of when we can get the full MAX-9 fleet back operating and it really just comes down to the 23 deliveries. We did have some planned retirements, and we had some allocation for work to refurbish some interiors. So we've got some moving parts and pieces we can sort of flex around to get to the right capacity number.

But as we mentioned, as we look at it today, it's going to be below the range we had originally thought, which was 3% to 5%, and it could well -- very well be below 3% at the end of the day.

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

And then just relatedly, have you made any changes with respect to hiring? Have you paused hiring? Have you paused training resulting from this event?

Ryan St. John - *Alaska Airlines, Inc. - VP of Finance, Planning, & IR*

Duane, this is Ryan. We already came into the year given the low growth profile with not much hiring required, I mean, some, of course, to backfill any attrition, but we've sort of left some optionality on the table. We've got a couple more months to make some decisions on that relative to our summer schedule. So we'll be talking about that the next few months, obviously, if there's any delivery delays or anything, maybe we don't need some of those last training classes in the spring. But we've still got them available if we need them if we can find the capacity.

Operator

And we'll move next to Conor Cunningham with Melius Research.

Conor T. Cunningham - *Melius Research LLC - Research Analyst*

Sorry to go back to the $150 million headwind, but I'm not quite clear -- it's not quite clear on what actually is lost revenue versus cost impact. I don't know if you could provide any clarity there, that would be helpful.

Ryan St. John - *Alaska Airlines, Inc. - VP of Finance, Planning, & IR*

Yes. Conor, this is Ryan again. So the majority of that $150 million is revenue, costs I would say, are kind of a wash because obviously, all the canceled flights, we saved on fuel and landing fees. But as you can imagine, we've incurred significant over time as our operational employees are working around the clock to keep the new schedule going, a lot of passenger remuneration and things like that.

So it's mostly been revenue. I mean, as Shane sort of mentioned, small assumption for maybe some booking challenges in February as we get the fleet back operating. But we're sort of assuming by March, we're back on the original trend there. So that's kind of what it breaks down as it's pretty much mostly revenue. And the point being that it's at least $150 million because obviously, any changes to delivery streams or capacity might further impact that. But it's pretty much cancels to date plus the small amount of booking impact in February.

Conor T. Cunningham - *Melius Research LLC - Research Analyst*

I got you. Okay. That's helpful. And then you mentioned the 30% profit improvement on network changes in 1Q. Can you just -- can you just provide some details on what that actually means? And what's driving the change? Because it seems like a pretty significant long-term impact for you guys. So any help there would be great.

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

Conor, it's Andrew. Yes. Essentially, it's the reshaping of the network. I mean we have significant double-digit increases in certain regions of our network, which performed very poorly last year due to the lack of business and just a change in behaviors. And then we have some very high double-digit growth in some of our sun destinations and other core routes.

So it's really just -- '22 was obviously an interesting year with all the huge demand surge and we're now in a normal place. So -- and as we've looked at it, it's really revenue driven. It's just reshaping and flying where the demand is, getting better day of week, seasonality, California versus the Pacific Northwest, so we're very, very happy with the results.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

And Conor, I'm going to add that, remember, our goal is to reduce losses in Q1 and get to breakeven or better. So that is the long-term objective.

Operator

And our next question will come from Andrew Didora with BofA Global Research.

Andrew George Didora - *BofA Securities, Research Division - Director*

Ben, it's very early days since the incident but the comments today in the National Media this week. Just I guess, where is your relations going after this? And guess what needs to happen to make you rethink your single fleet type at this point?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Thanks for your question, Andrew. Well, look, where I stand is flight 1282 should never have happened. It should never have happened at all. So we have a long-standing deep relationship with Boeing, but like I said, it's not acceptable what happened. We're going to hold them accountable and we're going to raise the bar on quality on Boeing.

So we have the relationship. We're having tough candid conversations. And my goal as a CEO of this airline is for every airplane that comes out of that factory it's going to come out with a higher degree of quality and reliability that has been in the past. So I think it's the virtue of our relationship that we can have these tough conversations, maintain the relationship and continue. We got 231 737s that we've been happy with. And until this incident, we were happy with the MAX.

We have 185 on order that are coming to us. We believe with the network configuration we have, this is, of course, ex Hawaiian. The network configuration we have, the Boeing airplane is 737 is well suited for our network. So that is the long-term plan, but we're going to hold Boeing's feet to the fire to make sure that we get good airplanes out of that factory.

Andrew George Didora - *BofA Securities, Research Division - Director*

Thank you, Ben. And then my second question for Shane. You have to say like your most of the calls last year, I think you were certainly a bit worried about industry domestic capacity growth over the course of 2023. As we sit here in January of 2024, what are you most worried about outside of getting the MAX 9 back up and running?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Andrew, you cut up just a tiny bit at the end. But yes, I think -- and Andrew was alluding to it, it's been -- there's been a lot of predictions across management teams, across analysts, and observers about what the new normal of demand would be coming out of COVID.

I think it was a little bit anybody's guess, and we were all trying to respond to the best information we had last year. We were all also trying to get our companies back to pre-COVID operational levels, which made sense. And so a lot of that seemed to come at the tail end of the huge demand surge that started in 2022 and sort of carried through 2023 summer. The good news is, it seems like demand is holding very well into the first quarter this year. I think the airlines across the board are starting to understand that demand is looking a little different than it did pre-COVID, but probably not as different as we all thought it might have been.

And so there's still seasonality in the business that looks a lot like pre-COVID. And I think Andrew and his team have done a great job responding to that this year as evidenced by the improvement of the Q1 profile ex the grounding. So we're feeling really good about our capacity outlook. We obviously want these planes. We felt like we had a good plan for them this year. If we don't get them, we've got some work to do to make sure we maximize the results we can get with the current fleet.

Operator

And we'll move next to Jamie Baker with JPMorgan.

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

Ben, I can only speak for myself, and I'm not under the illusion that my opinions really matter that much to you. But I actually think you and the team have been handling the MAX situation very, very well. My first question actually relates to Silicon Valley Bank implosion last year. We're coming up in the anniversary in March. Can you remind us how California in particular -- California demand behaved in the aftermath? Both in terms of magnitude and duration?

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

Jamie, you're testing my memory here. But what I recall at the time -- in relation to our California network, it was not that significant. There was already high-tech softness. I will tell you to take the opportunity that we've been very happy with California performance. We remain 18% down vs pre-COVID level but we've seen unit revenue performance from California this year and 2023 outperform system average.

We've seen where it's profitable and in fact, it continues to close the margin gap from our system. So we feel really good about the continuing refinement and strengthening of our California franchise.

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

Okay. And then just a quick question on guidance. Most of my earlier questions have been addressed. But assuming you do revise and ex fuel CASM guide after this quarter, will you be accruing for the flight attendant contract?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Jamie. I think that we will guide when we're prepared to do so inclusive of all of the costs that we think are coming our way this year. I don't think we would start accruals. It hasn't been our practice in the past, and I don't foresee us changing that practice.

Operator

Our next question will come from Helane Becker with TD Cowen.

Helane Renee Becker - *TD Cowen, Research Division - MD & Senior Research Analyst*

So I just have kind of 2 questions here. One is -- as you think about the MAX coming back into, MAX 9 coming back into service, do you think you'll have -- customers? And do you think you'll have to discount to encourage them to fly the plane? Or do you think that a plane's a plane to a customer who may not be a sophisticated observer?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Helane, it's Ben. Like we said before, we have customers who love our company. They trust us. They know we put safety and reliability first. There's no doubt that the MAX 9 has a lot of attention, and people are looking at what they're flying. But our goal right now as we reenter the MAX 9 just to give our employees, particularly our crews, the confidence that Alaska has done everything it can to put our MAX 9 safely and in airworthy condition back in service and to communicate with our guests.

And if they have any concerns to reach out directly to us, to our crews, to assure them that the aircraft they're on are safe. And we won't put any, of course, an aircraft back in service that are unsafe. But I think at first, people will have some questions, some anxiety just like they did 2 years ago or when the -- after all the deep certification process the aircraft went through. But I believe over time, the confidence will get back into this airplane.

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

And Helane, I just might add real quick that what we've been seeing in the -- is just really schedule reliability. And that's been the concern. But sort of in 8 days from now, we'll have the 9 fully back deployed and we fully expect our completion rates to go right back to 99%, our on time back to our goals, so that our guests can be assured that when they book on Alaska, they're going to get to where they need to go safely and on time.

Helane Renee Becker - *TD Cowen, Research Division - MD & Senior Research Analyst*

Okay. So can I push back just a tiny bit and say from what I've read, and if I'm wrong, if the reports are wrong, that's fine, just tell me. There was an indicator light that went off a few times that caused you guys to move the aircraft in question out of the Hawaiian market where it was flying and over land in case something happened, and of course, something did happen. Is it that the indicator didn't tell you where the problem was? Or is it that maintenance thought it was faulty? I mean, how should people think about that because when you're checking engine light goes on in your car you check it out.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Yes. Helane. I'm glad you asked the question because I want to set the record straight on this. And I'll probably take a little bit of time and you're making me put on my old operations and maintenance and engineering hat back on, which I'm glad I love putting it back on. So I'm going to say it right from the start, the issues were completely unrelated. And I'll explain why here if you give me some leeway.

What we had was a pressure controller issue. And the pressure controller has 3 modes of operation. It's got an automatic mode. It's got an alternate mode, and it's got a manual mode. What failed with the light that your talking about that went on was the automatic mode switching to alternate mode. And that's perfectly in line with the pressure controller. It has 1 primary and 2 backups. So the pressurization was never an issue on the airplane. The reason we restricted it from going over water, and this is stuff when I was back in maintenance is we've taken an abundance of caution.

We're saying, look, we have other airplanes that we can send over water. This one, the light went on. It's still working perfectly well. It's legal to send over water. We'll be a little more cautious. We'll keep it over land, so we can watch it and keep it between maintenance bases. So I just want to be totally clear. These 2 issues were totally unrelated. This was an issue with the door plug. We got a faulty door plug from Boeing, totally unrelated to the light or to the pressurization issues.

Helane Renee Becker - *TD Cowen, Research Division - MD & Senior Research Analyst*

Okay. Well, I appreciate that explanation because, as I said, I didn't know, and now I do.

Operator

And we'll move next to Catherine O'Brien with Goldman Sachs.

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

Shane, maybe one for you first. So you guys called out that you expect to lose about 7 points of capacity from the MAX grounding in the first quarter with capacity now to be down mid-single digits. Can you just help us think about what you were targeting pre-MAX for CASMex? -- sounds like capacity was going to be up low single digits if I'm doing that correctly. I'm guessing a lot of the fixed costs remain. Is it safe to say like there's about a 7-point headwind to CASMex versus what you were expecting on the old growth rate? Or any color there would be super helpful.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Sure. Yes. I mean I sort of gave a previous answer, Catie. We didn't -- we haven't managed any cost out of the system, Ryan, I know it's a little bit of a puzzle. Ryan told you that the $150 million really is revenue because the costs wash. We've incurred some additional costs, certainly with passenger remuneration, reaccommodation costs, a lot of overtime in premium, the costs saved are really landing fees, food and beverage and fuel.

So there's more net cost headwind in the quarter, and we didn't take any other cost out of the business because obviously, it happened January 5, and there was no time to react. So certainly, the -- it's almost a one-for-one impact to the quarter. But we haven't also guided to what we thought Q1 was going to go to. We just feel like we need to get certainty around what this looks like and then we can give a full year guide if we choose to do so in the future.

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

Okay. Fair enough. And then, Andrew, maybe 1 for you as well. Can you help us size some of the drags to your unit revenue from tech corporate lagging, Maui, anything else you want to highlight in the fourth quarter? And then how those items are trending into the first quarter? One of your competitors called out recently a boost in corporate at the start of the year and part driven by tech. So I would just love to kind of hear how maybe some of the drags in 4Q trending into 1Q.

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

Yes. Thanks, Catie. Just to touch on Maui real quick. We had already adjusted our capacity down, I think, like 14%, 15% in the fourth quarter, it's down even more in the first quarter. So we feel like we've got our capacity somewhat aligned with demand in Maui. One of the unfortunate challenges as I shared in the Q4, we were seeing good momentum in corporate travel, of course, anything from 0 to 14 days was severely impacted by the MAX 9 in January. So it's a little bit hard for us to comment on the business side. But again, we have continued to see good momentum in average fares for business travel, and I don't see why that would not continue.

Operator

And our next question will come from Mike Linenberg with Deutsche Bank.

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

Andrew, I appreciate all the color you gave around loyalty, ancillary, some of the premium data. I think calling out that 46% for premium and ancillary and other. I'm not sure I've seen that number before, and that was actually a bit higher than what I thought it would be or thought it was. From an aspirational perspective, where do you think you can get that? And how also does that aspirational goal change in the event that you decide to do lie-flat maybe in some of your domestic markets?

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

Thanks, Mike. So a couple of things. We are continuing to see good demand for our premium product with the team, both on the revenue side and how we manage it. And also, we still have a lot of marketing opportunity and upsell to go. So I still expect good strength there. We added a row on our 175s additional premium class. We're also -- we'll be adding additional premium class in our 8s and 9s with our -- some of our reconfiguration. Of course, the challenge always is making sure that we don't completely squeeze out our top-tier elites from the front cabin, and we feel like we've received a full good balance there.

But -- and overall, we continue to look at our cabins, and we continue to look at our network and we continue to look at what are the right seats and densification of our premium cabins given the environment and especially if we continue to see this remain strong.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

And Mike, I just want to shine a little more of a light on your question. Again, we had a 7.5% pretax margin close to United and Delta, again, without the international tailwinds, with the fuel headwinds, and yet our margin was as high as it was, simply because of your question, because of our premium offering.

Our business model competes with the network carriers. We are differentiated domestically with our competitors. Our airplanes are 100% fully configured in premium, again, with our loyalty program, with the way the business model is set up with lounges. So it is a reason why we see success even when there's shift between domestic and international. And again, we'll have more success with the Hawaiian acquisition. So I just wanted to shine a bit more of a light on that.

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

Great. And just sort of a follow-up and maybe it just sort of leads to this next question, which Andrew, are you sort of making that comment about part of the industry really starting to acknowledge what you refer to as these post-COVID demand realities. And I'm curious, at least from the low end, in any of your markets, what you're seeing on competitive capacity, maybe any notable markets that you want to call out where you've seen some meaningful shift that should be to your benefit? Any color there would be great.

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

Yes. I think the only color I'd probably add there, Mike, is -- and I also -- when we look at it, we look at weighted average capacity in our markets, and we just see a trend that's getting less and less. We have seen some carriers who play more on the East Coast, move into the West Coast and reduce their capacity. Again, as the industry looks to make sure that their revenues and their costs all work to make sure margins are strong and healthy. So we see the construct for the industry right now as one that's positive.

Operator

And our next question comes from Stephen Trent with Citigroup.

Stephen Trent - *Citigroup Inc., Research Division - Director*

Most of my questions have been answered. Just one really quick one. This might be for you, Shane. When do you think about that very good credit rating you guys have from Moody's. To what extent does 1 or 2 moves up or 1 or 2 moves down, make a meaningful difference as you guys go and negotiate with your co-branded card and fuel hedge counterparties and other similar entities.

Nathaniel Pieper - *Alaska Airlines, Inc. - SVP of Fleet, Finance and Alliances*

Stephen, great question. It's Nat. One of the many hats I wear is Treasurer and getting a ratings agency question is just Manna from heaven. So thank you. Really excited that Moody's gave us the investment-grade rating. We've got a really good story as Ben hit through in his commentary: cost execution, terrific operation, balance sheet has been core for so long. And we look at that investment-grade rating just as affirmation from an external source that our story is very strong. It certainly helps us when we go into the capital markets, we go negotiate whether it's for leases, fuel contracts, et cetera, as you say.

And it also gives us confidence as with the Hawaiian acquisition and really moving forward, seeing recognition from external parties that the Alaska story is strategically sound.

Operator

And we'll move next to Dan McKenzie with Seaport Global.

Daniel J. McKenzie - *Seaport Research Partners - Research Analyst*

So I guess my first question is for Andrew. Going back to the script and the more to come comment, of course, that's going to be my question here. So optimizing upsells, NDC, better merchandising, I guess, first, has Alaska cut over to NDC at this point? And then related to that, how many bookings and how much revenue is on third-party GDSs today?

And I guess what I'm really trying to get at is just the percent of tickets Alaska is upselling today on third-party GDSs and what that upsell take rate might look like on alaskaair.com?

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

Thanks, Dan. Just in short, we are -- this '24 is a big year for us. There's something like 12 APIs that we're building out to fully unlock NDC. We have a number of modules already up and running on folks like hopper. So it's actually small percentages right now, but we're seeing the benefits of it, and it's going to be really good for us, '25 is going to be the year of NDC for us.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

We're building the piping this year. That's what you're saying.

Daniel J. McKenzie - *Seaport Research Partners - Research Analyst*

Okay. Understood. And I guess another question on IT. Has Alaska begun the transition to the cloud? And if that's something you're looking at, could you help us size that level of cost savings from that shift? And also elaborate a little bit on timing?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Thanks, Dan. We have been transitioning to modern platforms for a while starting 6, 7 years ago through the Virgin transition. We are starting to move more of our core IT and more of our sort of commercial e-commerce technology stack into the cloud. We're big fans of our partners up here in the Pacific Northwest, Microsoft, but we also use other folks as well as them.

I think the big thing is it's a cost increase. It's a CapEx increase initially and then you need to scale over many, many, many years. And I think it's going to bode well ultimately for cost efficiency in the years to come.

The other thing is we are going to benefit from artificial intelligence, Gen AI. We've set up a full team to go focus on that. We're lucky to be in sort of one of the tech capitals of the world who are working on this stuff with a really great partner of Microsoft up the street. So not anymore today because the time is over or I would have gone on for 5 minutes with you.

But we're going to get an Investor Day together this year, and we want to talk about technology and AI and the benefits to the company when we get in front of all of you guys later this year. I appreciate everybody's question we'll have Ben wrap it up.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Thanks everybody for joining us on our call. Thank you so much. We will keep you updated on our progress with the 9 MAX and thank you so much, and talk to you next time.

Operator

This concludes today's conference call. Thank you for attending. Goodbye.
