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ALK - Q3 2017 Alaska Air Group Inc Earnings Call

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OVERVIEW:

Co. reported 3Q17 total revenues of $2.1b, adjusted net income of $278m and adjusted EPS of $2.24.

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PRESENTATION

Operator

Good morning, my name is Devon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group's Third Quarter Earnings Release Conference Call. Today's call is being recorded and will be accessible for future playback at www.alaskaair.com. (Operator Instructions) Thank you.

I would now like to turn the call over to Alaska Air Group's Managing Director of Investor Relations and Financial Planning and Analysis, Lavanya Sareen.

Lavanya Sareen - *Alaska Air Group, Inc. - MD of IR*

Thanks, Devon, and good morning, everyone. Thank you for joining us for Alaska Air Group's Third Quarter 2017 Earnings Call. Before we jump onto the call today, I want to quickly introduce Matt Grady, our new Director of Investor Relations. Matt covered transports on the sell-side and most recently was part of the Corporate Strategy team at Starbucks. Matt brings a fresh perspective and deep financial acumen to the team. We're super excited to welcome him into the Air Group family and I'm looking forward to working with him.

With that, let's jump in. On the call today, our CEO, Brad Tilden, will provide an overview of the business and share progress on Virgin America integration; our Chief Commercial Officer, Andrew Harrison, will share an update on our revenues; followed by Brandon Pedersen, our CFO, who will discuss our financial results and outlook. Several members of our senior management team are also on hand to help answer your questions.

As a reminder, our comments today will include forward-looking statements regarding our future expectations, which may differ significantly from actual results. Information on risk factors that could affect our business can be found in our SEC filings. We will refer to certain non-GAAP financial measures such as adjusted earnings and unit costs excluding fuel. We have provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in our earnings release.

On to results. This morning, Alaska Air Group reported a third quarter GAAP net profit of $266 million. Excluding merger-related costs and mark-to-market fuel hedging adjustments, Air Group reported an adjusted net income of $278 million, which was $6 million higher than last year's net income of $272 million, and our earnings per share grew by 2% to $2.24. Said another way, Virgin acquisition has been accretive in the third quarter and was accretive in the first 9 months since close of our merger. However, the net income did decline on a combined comparative basis. We have included certain unaudited supplementary data labeled Combined Comparative Statistics on Page 7 of our earnings release, update to help investors make meaningful comparisons to the combined results of both airlines in last year's third quarter. Additional information about cost expectations, capacity plans, fuel hedging, capital expenditures and other items can be found in our investor update included in our Form 8-K issued this morning and is available on our website at alaskaair.com.

And with that, over to Brad.

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

Thanks, Lavanya, and good morning, everybody. With 3 quarters of 2017 now behind us, we continue to be very enthusiastic about our results and our future, and about fulfilling our purpose of creating an airline that people love. Economic activity in our West Coast markets remain strong and our core business continues to perform very well. Our franchise is growing in California and we're pleased by the response we've seen to our expanding network, to our focus on hospitality and to our generous Mileage Plan. While our third quarter results were impacted by some operational challenges and by industry pricing pressure, we are addressing these issues as we'll discuss in a moment.

For the quarter, our operating revenues grew to a record $2.12 billion. On net revenue, we earned a pretax margin of 21% and pretax income of $446 million, which is up 4.4% from the third quarter of last year. Though down on a combined comparative basis, our results were solid, given the ongoing integration and given that fuel prices were up 14% year-over-year.

From an ops standpoint, we've come a long way from the beginning of the year, but we still have work to do. We ranked second out of the 6 largest carriers on on-time performance for the quarter, up from nearly the bottom of the pack during the first quarter. While we're pleased to have closed the gap with our competitors, we remain committed to getting back to the #1 position on this metric.

And as many of you know, Horizon Air has encountered some challenges of late. Pilots have been leaving regional airlines for mainline opportunities at higher rates than in the past and at higher rates than we anticipated. The introduction of E175s to our fleet has also increased our training needs. We ended up being short pilots and we scaled back our schedule, especially in August and September. We've now adjusted our schedule to match pilot availability, and cancellations have dropped dramatically. We've made a number of leadership changes as well and we're also consolidating our Horizon leadership team and our operations center in Seattle, giving us a much better ability to develop talent across Horizon and Alaska. I'm confident that these adjustments will position us to run the airline smoothly as we head into 2018.

Now let's talk about our growth. Those of you that have followed Alaska for many years know that growth is nothing new for us. We've been expanding capacity at a 7% to 8% rate for more than 20 years now. New markets added at Alaska by itself since 2010 will account for about 1/4 of this year's revenues and profits. Our growth this year has been focused on California. 32 of the 44 new markets we're opening this year will serve the state. And with this growth, we're putting the building blocks in place to expand our base of loyal customers. Nevertheless, this growth will not come without challenges. We know our growth rate is high, even for us, over the next few quarters and this is during a period of yield softness in the industry.

As has been reported by others, this quarter, we saw pricing pressure, especially in our transcon and inter-Cal markets with walk-up fare levels being well below historical norms. While we believe these prices are not sustainable, they are nonetheless continuing into the fourth quarter. And as a result, I've asked our network planning and RM teams to evaluate every market we fly to, to ensure we have the right amount of capacity deployed to generate acceptable margins and returns. Andrew will talk more about this in a moment.

Turning now to the integration. Our team is doing great things. We met several key milestones this quarter including Mileage Plan reciprocity, station co-location at 11 of the 24 airports and the launch of an internally developed technology that allows gate agents to switch between Alaska and Virgin check-in and boarding applications. The next 8 months will be very important as we expect to complete several additional milestones.

In January, we expect to convert to a single payroll, HR and financial systems. We'll fully integrate our loyalty programs, we expect to receive a single operating certificate from the FAA, we'll begin the rollout of satellite Wi-Fi across the fleet and we'll repaint our first Airbus airplane in the Alaska livery. In the spring, we plan to cut over to a single passenger service, or PSS system, and this will allow us to unlock many of the revenue synergies we shared with you at Investor Day. And then, in October we'll configure our first Airbus interior to the Alaska layout.

By the middle of next year, our most critical integration milestones will be behind us, and we're thrilled about this. The fact that we remain on track to complete all of our goals on schedule is a testament to the quality and dedication of our fantastic people. These people have been working extremely hard. I want to personally thank them for the many sacrifices they are making to get this integration done and done well. We're in the midst of an important transformational period for our company. Nothing worth doing is easy and every meaningful thing we've accomplished in the last 25 years here has faced challenges, and this is no different. But during that time, we've also been steadily and consistently building a great company, and that's what we're going to keep on doing for all of the people who are counting on us to do so. Our customers, our communities, our employees and our shareholders.

Thanks very much, and I'll now turn the call over to Andrew.

Andrew R. Harrison *- Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

Thanks, Brad, and good morning everybody. As Brad mentioned, total third quarter revenues grew 5.4% to $2.1 billion. Demand in our core business remains robust and healthy momentum in California continues. Our capacity team has been busy building an expansive network on Virgin America's strong foundation. In addition, we've made substantial progress on the integration with approximately 1/4 of all Virgin bookings now flowing through AS.com, our revenue management systems fully integrated, a clear line of sight to implement new product and services on both the Airbus and Boeing fleets and the co-location of Virgin and Alaska operations at the major airports such as LA, San Francisco, Portland, Seattle and New York, for the convenience of our guests.

Now some color on the third quarter. Now same-store markets, well, markets that have been in operation longer than 1 year, performed well. Same-store capacity, representing approximately 94% of our total capacity, grew 0.7 point, while RASM was slightly positive. Same-store load factor was strong at 86%, while certain yields suffered from close-in pricing, primarily in inter-California and California transcon, both driven by our need to be competitive with OA actions, and I'll expand in more detail when I get to the fourth quarter outlook.

The challenges at Horizon also impacted our same-store results. Flight cancellations led us to either refund or reaccomodate passengers, which lead to displacement of higher yield bookings and lost revenues. We estimate this resulted in about $25 million to $30 million of revenue headwind or about 1.5 points of RASM. But as Brad mentioned, we've adjusted the flight schedule and Horizon is now running well, and we expect these revenue headwinds to be substantially lower in the fourth quarter and behind us by year-end.

Now turning to new market growth, which I know is very much on everyone's minds. The 20 new markets we commenced in the 9 months ended the second quarter of 2017 contributed approximately 1/3 of our revenue growth in the third quarter, with 60% of these markets already profitable and many returning double-digit margins. With that said, we fully acknowledge our pace of new market growth is very high, yet critical to unlocking the value of Virgin America. New market growth of 44 routes this year will not continue at the current pace and in fact, will slow to only a handful of new markets in 2018, the majority in the Pacific Northwest. As Brad affirmed, our custom utility is rising. As a reminder, we define utility as the percentage of total demand for geography where we provide a nonstop flight to help meet that demand. We're on track to achieve 70% utility out of San Francisco by year end, and that's up 11 points from the acquisition. Now utility is also growing across the state of California, and by year-end we'll offer 44% utility to California customers. That's up 28 points from our 2016 premerger network of only 16 points.

And our data reaffirms that increased relevance leads to increased loyalty, as our loyalty program continues to grow nicely given our network growth. Mileage Plan membership is up 18% year-over-year. In addition, Alaska Airlines' Affinity credit card holders increased well above passenger growth. The Alaska Airlines brand also continues a strong march forward in the Bay Area with unaided awareness improving another 5 points and preference up 4 points since May. Unaided awareness for Alaska, which now sits at 50% exceeds what Virgin America had in the Bay Area prior to the acquisition.

Now as we look to Q4. We see a more challenging revenue environment and one that is closer to, but better than, September unit revenue performance, rather than July or August. Our 11% growth, which includes a 6% increase in stage length and new markets will pressure unit revenues. But the more significant challenge is what we have been experiencing in California, both transcon and inter-Cal. These 2 regions represent approximately 1/4 of our network. In some key California transcon markets, we are seeing close-in business fares, 0 to 7 days advance purchase, down 20% to 35%, yet demand remains strong, and in some cases, industry capacity is relatively flat. Intra-Cal is no different, with close-in fares down 25% to 35%. To provide color, Boston-Los Angeles industry capacity was marginally down yet 7-day advance purchase fares were down nearly 50% -- or 56%, going from to $239 to $104. In Los Angeles, San Francisco, being an inter-Cal market, industry capacity was actually down 10% and 7-day advance purchase fares were down 38%, going from $160 to $99. Now we're doing our best to work through this, but we do not see any changes in this pricing environment as it stands today.

I now want to move and will provide actually a general sense of our planned capacity in 2018. We expect to grow about 8% for the full year, which is nearly 1 point lower that we were originally considering, the first half higher than the second half. Our focus will be on maturing what we started this year, with substantially all of our 2018 growth resulting from markets started this year, but excluding any PAE service tentatively expected to start in late '18. And we expect our growth in 2019 to come down further, at between 6% to 7%.

Before I turn the call over to Brandon, I want to reiterate that while the acquisition of Virgin America has brought a number of changes, our commitment to disciplined growth has not changed. My commercial team and I know full well we need to produce strong margins at the lowest cost. And if we do not see a path to achieving our growth objectives at adequate returns on invested capital, we will adjust cost and quickly.

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

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

Thanks, Andrew. Good morning, everyone. As you've now heard, Air Group posted a $270 million third quarter adjusted profit, a $6 million increase over last year's adjusted Q3 result. This equates to a pretax profit of $446 million and a trailing 12 pretax margin of 20%. On a combined comparative basis, that is with Virgin America's third quarter of 2016 in the base, our result was $68 million or 13% lower than last year.

Andrew covered revenues, so I'll cover costs. Fuel costs were up substantially or $70 million, which equates to 23% and nonfuel costs rose by $97 million. Unit costs ex-fuel were up 1% on 7% ASM growth. Operational disruptions resulted in about $6 million of incremental cost during the quarter, with airports and call centers most heavily impacted. Our call center team has worked extremely hard over the last few months and our employees there deserve a huge shout out. Not only did they handle the added volume from the disruptions, more guests are calling with questions about integration-related changes to our network and loyalty programs. The Q3 impact of those costs was partially offset by a shift in timing of some of the maintenance now planned for Q4. As we look to the fourth quarter, we expect unit costs to be up about 1.5% on the 11% increase in capacity. While that certainly doesn't make for a very impressive headline, there are several drivers.

First, we're pleased to announce that we finally signed a new engine services deal with GE that covers all 130 of our 737-800 engines. We're very pleased with the economics of this deal. A power by the hour structure will help take the lumpiness out of the engine overhaul expense over the next 9 years compared to a time and materials approach, but it does result in a near-term CASM impact, which begins in Q4 and will impact 2018.

Second, as I mentioned, we do have some maintenance activities planned in Q4 that were deferred from Q3, and we're also planning more advertising and promotional activity in the fourth quarter in support of our transition to one single Alaska brand.

And finally, the close-in capacity reductions on the regional side will also impact unit cost, because the fix cost gets spread over fewer ASMs. In fact, our full year 2017 capacity will now be up 7.2%, down from the 7.5% we guided to as recently as mid-September and way down from the guidance as high as 8.5% at one point during the year.

We are deep into the budget process now and expect to provide 2018 cost guidance in January. Our financial planning team and divisional leaders are digging into their businesses and together we'll be setting aggressive budgets. Although the budget is still in process, I thought I might call out a few significant items. First, the results of our mainline pilot arbitration. As we reported previously, the annual impact of the company proposal is $140 million, which we believe puts our pilots' total compensation in a very competitive position versus others in the industry, especially considering our relative size and our growth-oriented business.

At the $140 million level, it would result in a nearly 3-point increase in CASM X and will reduce pretax margins by more than 1.5 points. We expect the arbitrator award soon, and for the decision to impact Q4, which is not included in the Q4 cost guide.

The new engine services deal. This will add about $30 million of incremental expense over what I have been expected to incur -- excuse me, what we might have expected to incur on a time and material basis. But again, this is about timing, yet the economics over the 9 years are significantly better.

Third, the growing mix of regional flying, which will be up nearly 25% next year given all of the E175 adds. This will pressure CASM but also help RASM.

And finally, continued what I call integration friction. In other words, costs that don't get captured in the merger-related cost line on our external P&L but are real. This friction starts to decline right after we get through the PSS transition. Our job as leaders will be to ensure that we eliminate these costs as quickly as possible, and we don't let things like consultant and contractor costs get buried into the baseline or change our way of thinking and how we get things done around here.

Bottom line, our costs will rise in 2018, but we understand the importance of low cost of the business model and to the success of the company. We have a long track record of solid cost control and I'm confident we can continue to maintain a cost structure that gives us significant competitive advantage over the legacy carriers.

Our cash flow continues to be strong. We ended the quarter with $1.7 billion of cash on hand and we've now generated $1.4 billion of operating cash flow, excluding merger-related expenses since the start of the year. CapEx for the first 9 months of the year stands at just under $850 million, resulting in more than $600 million of free cash flow, again X merger-related expenses. We now expect full year 2017 CapEx to be $1.1 billion and 2018 CapEx to be $1.4 billion. Horizon's deferral of 5 E175s from late 2017 and early 2018 to the back half of 2018 explains the timing shift. Total 2017 and 2018 CapEx is basically unchanged.

Our fleet continues to get younger as we've now retired nearly all of the 737-400s. Through September 30, we've taken delivery of 10, 737-900 ERs, 2, A321 Neos and 10, E175s. Meanwhile, our portfolio of unencumbered aircraft continues to grow and is now at 63 aircraft or more than 20% of the fleet. We're also making steady progress re-deleveraging our balance sheet. Our debt to cap fell by another 2 points this quarter to 53% and we expect to end the year at about the same level.

Less than a year since we completed the acquisition of Virgin America, we've lowered our debt to cap by 6 points and are well on our way of achieving our longer term target in the low to mid-40s range.

Although funding growth and deleveraging remain our primary capital allocation goals, balance remains important. In that vein, we repurchased an additional 350,000 shares of stock last quarter. We've now completed our plan to repurchase $50 million worth of our shares in 2017. We've also paid $111 million in dividend so far this year.

In sum, this was a very solid quarter for us during what is and what will continue to be a transitional period. There's a lot of work ahead to get through the significant integration milestones so that we can begin to truly be one airline and fully realize the synergies we expect to achieve which are, by the way, on target. Andrew described a somewhat challenging fare, but not demand, environment that is pressuring revenues and I covered some near-term cost pressures that we'll be dealing with. However, we remain very optimistic that what we're -- about what we're building and the opportunity ahead.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Savi Syth with Raymond James.

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

Can I ask on -- I appreciate all the forward color provided today. On the 2018 growth, I wonder if you can provide some components on gauge versus the -- and a little bit more color on where that growth is going to be.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

Savi, this is Andrew. The growth next year, I think a few points of that is actually more like stage length, longer stage length. Gauge is I think roughly flat, give or take. And really, it'll break down to about 10 points of growth in the first half of the year and then second points of growth in the second part of the year. And as I shared in my prepared remarks, fundamentally, all of this growth is just the annualization of what we've started in 2017, which as we shared earlier, will be a lot of California and then some transcon, Pacific Northwest and Mexico City flying.

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

And if I -- if I might ask on the cost side, Brandon, is it -- are you kind of indicating that even without the pilot deals, kind of unit costs would be up next year, is that fair?

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

Yes, Savi. As I mentioned, we're still in the budget process, so it's too early to say for sure. What I would say is that I gave you a bunch of the pieces, the pilots are going to be probably 3 points of CASM. We do have other cost pressures that are just -- they're just these -- or the reality of the business or like the maintenance deal, really good economics that where the expense impact is different than what I'd call the cash impact, and then there's the mix issue. We do have this friction that I've been talking about and that's real, that will be in the first half of the year. As I said, it'll start to come out in the second half year. So it's probably a fair assessment to say flattish, perhaps up modestly, ex-pilots. But again, in terms of a specific quantification, really hard to do because I don't know the size of the pilot arbitration decision and I don't know when it starts. So it's hard to give you a percentage year-over-year change.

Operator

Your next question comes from the line of Jamie Baker with JPMorgan.

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

A question on Horizon and the pilot issue. I'm just curious, if you think you've taken a sufficiently proactive approach to reducing capacity further out than what you had been doing in the past. It felt initially like maybe you were running the airline just sort of in hopes that the problem might go away, or find some solution rather than taking the approach that there maybe this is just the new normal. I guess, I'm just surprised that after talking about this in the second quarter, we're still talking about it as it relates to the third quarter.

David L. Campbell - *Alaska Air Group, Inc. - CEO of Horizon Air Industries Inc and President of Horizon Air Industries Inc*

Jamie, Dave Campbell, good morning. Hey, just a little bit of a background for you there. Let me see if I can go back a little farther. I think, part of the challenge is really the fact that we got behind hiring initially last year because we're simply not competitive from a staffing -- from a pay standpoint. We've finally got a deal in place that allowed us to start to hire. The biggest challenge moving forward right now is now catching up on the training business. We're now hiring about 30 pilots a month, so feel really good about that, but it's going to take us another 90 days to really catch up on the backlog of training and moving forward, I feel very comfortable that we have a solid plan in place, it's going to work. What we're seeing right now is that pulling the schedule down to the levels that allow us to operate daily has made a huge difference already. So far this month, we've had 24 days in and of those 24 days, we only had -- we've had 19 days were we had no pilot cancels compared to last month, where we had on average about 500 cancels for the month. So we're getting a lot more control, a lot more flexibility, but it's really now about catching up on the training piece of business.

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

Jamie, it's Brad, I'd like to add onto that. This is on us. We should have seen this coming, and that's just all we'll say about it. But I think we're talking about it this quarter because it affected third quarter results on September 8th, so 1.5 months ago, we brought the schedule down and honestly, since those reductions it's run quite -- Horizon's run quite well.

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

Okay, and then, 2 just really quick housekeeping items. You mentioned the color on yield pressures, you set that down 25% to 30%, we were having trouble hearing that, that was related to transcon close-in business, is that correct?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

(inaudible) me, Andrew, let me quickly correct that statement. Yes, we're just saying, in select California transcon and even inter-California markets, close-in bookings down significantly, they seem to be (inaudible) state fares, they seem to be disconnected from demand. What we talked about was really September, looking into the fourth quarter, what we did say was that the fourth quarter will more likely resemble the September unit revenue performance, although we expect to be better than that, but that's sort of where we're seeing things the right now.

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

Got it. And just on that topic of Premium transcon, can you remind us the timing of when the Virgin Premium product starts to kind of harmonize with the Alaska product? I just, I view that Premium market is one that is increasingly less important over time to Alaska, that's why I'm asking the question.

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

Yes, Jamie. This is Shane. Just to be super clear, Virgin aircraft are going to be reconfigured to resemble the Boeing series that we've got, so we will densify the First Class cabin from 8 to 12 on most of the fleet, and the A321s will have 16 in the First Class cabin. That starts September of 2018, it's going to take us about 15 months after we get going to do the entire fleet (inaudible). Sorry, premium class will be a part of that, too.

Operator

Your next question comes from the line of Andrew Didora with Bank of America.

Andrew George Didora - *BofA Merrill Lynch, Research Division - Director*

Brad, I think you're obviously taking a lot of aircraft now through year end. I was just wondering if as the pace of delivery schedules sort of limits your ability to cut capacity further in 2018? If you feel like demand or your operations warrant it?

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

Yes, so Andrew, we don't have as you are sort of saying, we don't have a lot of close-in control over capacity. But what I would share is, we feel super solid about this strategy. What we are seeing -- the competitive pricing that we're seeing in California is a little different than we expected and then maybe to give analysts a little bit more context. If we look at our third quarter RASM, the Alaska RASM, sort of the legacy Alaska market, was flat. The RASM in the legacy Virgin markets was actually down 8%. So that -- we actually are thinking about this, and Andrew gave you some sort of insights as we look forward to sort of the back part of '18 and '19, we did have some thoughts on '19 that we're actually pulling in a little bit. But yes, there's not a huge ability to control capacity near term, but we're always thinking 12, 18, 24 months out. And if anything, we're pulling in that thinking a little bit right now.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

The other thing I would just quickly add there, Andrew is, we do have real flexibility, certainly on the regional side. We've taken 21 -- 25 Embraer 175s next year and we have 2, 400s that we are basically putting on the ground starting today and bringing that fleet down. So we do have flexibility in the retirement of the regional fleet that will -- which is a decent part of our growth next year.

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

And maybe Andrew, you're making a good point. We don't have huge flexibility with aircraft deliveries. I mean, what we've actually asked these guys to do is go look at ASMs by day of week, by number of frequencies per day and adjust those to come up with the most -- the best position for the company on our flight schedule.

Andrew George Didora - *BofA Merrill Lynch, Research Division - Director*

Got it, that's helpful. And then Andrew, maybe more a point of clarification in terms of your 4Q RASM commentary. I know September had some impact from the Horizon pilots, so your comments for 4Q, are they referring to the reported September RASM, I think it was down around 5.5, or were you talking more toward the core trend, ex the Horizon disruption?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

I think my only -- there'll be a little bit of Horizon disruption in the fourth quarter. I think my comments were really to try and frame for everybody that our unit revenue performance is more likely this September, but less than that is what we're seeing right now. So again, I don't want to get too prescriptive there, but on 11% growth, I'll also tell you that October is our peak growth of 12% and going forward, that will be the highest capacity growth and it's just going to come down from there.

Andrew George Didora - *BofA Merrill Lynch, Research Division - Director*

Would you be able to give us a sneak peek into what -- how October is trending right now?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

I'm getting stares from the CFO, so I'm going to have to -- I'm sorry.

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

It's Brandon. This is an answer that again, demand is solid but we're seeing some close-in pricing that is puzzling to us.

Operator

Your next question comes from the line of Michael Linenberg with Deutsche Bank.

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

Two questions here. Andrew, I want to get back to just how you qualified the growth in 2018. I mean, I think you said that a lot of it or the majority of it was really the annualization of '17. But the '18 number, it looks like it's going to come in higher than what '17 was, and I'm not sure if that reflects the fact that you had to pull down a bunch of E175 services that should have been in the schedule, and maybe they're coming back in '18. Like what, can you just really give us a little bit more color on that?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

Yes. I think a couple of things. I think as you've heard, we've had -- Alaska's mainline, its completion rate, has been 0.5 point lower than historic standards, Virgin has been 1.5 points lower than I think historic standards and Horizon has been, I think sort of 4 points lower than historic standards. So I think for 2018 -- 2017, excuse me, our completion rate of ASMs was down. Operational reasons and of course, to your earlier point. And I think going forward, as we go into 2018 again, we've got big stage length -- decent stage length increases, and we continue to upgauge our fleet. So I think there's a little noise here and there. I think we're going to be at 7.2% this year. We'll get more clear for you, but it's roughly on about the same basis if we run a full schedule this year, is my -- because we started off at 8.5%, I think, something like that. So we ended at '17, so.

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

Okay, that makes sense. And then just to Brandon. In the third quarter, you had a free cash deficit and I see it, obviously you paid the dividend, you bought back stock. And I'm just curious about the fact that maybe you have a more seasonal operation with the transcons if it was just a shift in the ATL and that had a bigger impact now that you have Virgin in the fold. What kind of drove that? Maybe it was that bad, or was it something else?

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

Free cash -- hey Mike, good morning, it's Brandon. Well, I hadn't really focused on the fact that we had a free cash deficit.

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

It looks like it was about $300 million. And we get that for -- seasonally, we see that with a lot of carriers.

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

Just off the top of my head, it's probably a pullback in the ATL, just as we get through the summer of flying. It's probably the timing of pre-delivery payments on deliveries, and that's probably it. There was nothing significant that jumped out during the quarter that would result in a free cash deficit other than like you say, just the normal seasonality combined just with the timing of capital expenses (inaudible).

Mark Gregory Eliasen - *Alaska Airlines, Inc.*

For the year, our free cash flow will be very solid though, just to point out.

Operator

Your next question comes from the line of Hunter Keay with Wolfe Research.

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

So, so look, I know mergers are hard, but it does feel like what's been happening here is really not what people are used to with you guys. That the execution has been sloppy, there's been bad cost control. It feels like the old, sort of Alaskan narrative is increasingly irrelevant to the investor story right now. And a lot of that relates to cost. So I appreciate you're still in the budgeting process and you've given us a reasonable amount of color on 2018, and I appreciate that. But, and maybe can answer this today, maybe you can answer it in a month or 2, but can you guys give some thought to providing a multi-year CASM ex-fuel look. A lot of the other airlines have done that, but I think you guys have really the track record and the credibility to do it, where people can actually kind of buy into it and believe and hang onto it, like something that sort of the old Alaska had, before you sort of lost this mojo, which I think really kind of started around the Analyst Day. So have you guys given any consideration to that either today or some point in the future?

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

Hunter, it's Brad, I'll start and then we'll -- maybe Brandon or Ben want to jump in as well. I think you're making -- mergers are hard, is the simple thing. We announced this thing April of 2016. We closed it December of '16. We sort of have been focused on this thing for, what is that math, 1.5 years now or something like that, and honestly, we've got another 6 or 8 months to run hard. What we're trying to do organizationally is say, look, this thing is done middle of next year, and we're back to running an airline. I think your characterization is right, we are good airline operators. We're good at managing costs, we're good at managing operations, we're actually good at managing revenues. But we have been a little bit focused on the merger. And the sooner we get back to getting them -- the sooner we get to the place where the merger is done, when we're running the airline which means whatever is getting close to our people, budgets, all of that stuff, the better. I think you're asking a great question. Honestly, a hallmark of us is we like to have -- we go back -- we do like to have 3-year cost targets, whether we share them or not for each of our divisions in terms of what they're doing, productivity and volume and so forth, so. I think that's a great challenge for the leadership team, to see if there's something that we want to come back all of you, and communicate with. But the big picture, it is what it is. This merger, it does change a culture. There are literally hundreds of systems that you have to get through, there's labor's agreement, there's people, there's jobs moving and it does take your eye off -- you actually do have to shift from what I think this company does best. And I'll just say it from my own perspective, the sooner we get this thing behind us and get back to doing what we do well, the better. And I personally think that will -- middle of 2018 at the latest and honestly, I'm shifting my attention to that right now. Ben? Brandon, is there anything you guys would to add to that?

Benito Minicucci - *Alaska Air Group, Inc. - President of Alaska Airlines Inc and COO of Alaska Airlines Inc*

Hunter, it's Ben. Our entire operations team is focused on the same thing. As you know, our -- we're trying to do both, we're trying to run an integration, we're trying to run 2 operations and keep an eye on cost and it's -- just take it from me, example, I'm in the Bay Area half the time and we're looking forward to midyear when we start getting focused and getting back to what we do best, which is running a great operation, to keeping costs tight and delivering on our goals.

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

And -- this is Brandon, maybe I'll just close. I can assure you that we are more frustrated than you about this whole thing, and there's a lot of anxiety around here, there's been a lot of tough conversations in the last few weeks about this. We've already started talking about this notion of a glide slope, to get from the place we are now to the place we want to be, and...

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

Yes, no, I'm not frustrated. You're better than this. Your investors are frustrated. I mean, I'm just an analyst. I'm just trying to just sort of do the work and forecast things. But -- I know, I get the frustration. But I think a multi-year guide on cost from you guys in particular, might be powerful, something to think about, just for the future.

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

Hunter, we'll give it honest thought.

David L. Campbell - *Alaska Air Group, Inc. - CEO of Horizon Air Industries Inc and President of Horizon Air Industries Inc*

So Hunter, David Campbell. I'll all add one more comment, and that is the fact that, before Horizon, we weren't distracted by the merger. Our issue is that just we didn't see the amount of attrition that was coming for us, we're not prepared for, having training capacity that actually can handle the operation. So we have 6 new leaders inside of Horizon, flight ops teams, so I have a lot of confidence when I get back to running a great airline.

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

And then Brad, when you say you're asking your network team to review new markets, that felt like a -- you were trying to tell us something there. I mean you emphasized that, I think there is a headline in Bloomberg about it. Don't you do that anyway? I mean, I would assume that's something you guys always do, and then the comments around sort of like the inflexibility around capacity, I mean, what can you really do there? And then like what's new? What were you trying to tell us in that statement that's actually new? And what are the potential outcomes from it?

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

Good question. We -- so in the last 12 months, we bought Virgin America, we got a lot of revenue, a lot of markets that we -- that we don't -- these weren't our market decisions, it's not our history. Then on top of that, we've added 44 new markets on there. And I think what we're saying is, I am not only pleased, but I'm like really impressed with this team's ability in legacy markets to go in and understand the natural demand to build a schedule, day of week, time of day, number of frequency that is exactly right for that amount of demand and our competitive position. I would say yes, we -- it's a fair question, don't you do that anyway, but that's a -- it's a good question, but I would just say we haven't done that with the Virgin network, and I think what you'll see us do, go into that network and I'll just say it, a lot of this stuff is extremely important to us strategically. So a lot of this stuff isn't going to change, but there's something in there that you might see changed. There are frequencies, there are markets they were 3 a day, 2 a day may be a better, a more profitable outcome with this, and there may be things geographically that you'll see us change. So that's what we're really trying to say, is that we are getting our arms around the Virgin network, we're starting to think about it. We're not making an announcement today, but I think you will see something down the road, you'll see some adjustments to the part of the schedule that we inherited from Virgin America.

Operator

Your next question comes from the line of Susan Donofrio from Macquarie Capital.

Susan Marie Donofrio - *Macquarie Research - Senior Analyst*

I just wanted to circle back to your new market. You had made a comment on the last call, that you thought you were seeing kind of a quicker ramp-up than the normal 2 to 3 years, and obviously I recognize that there's some competitive dynamics going on overall, but are you still comfortable in what you're seeing with that?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

Yes, Susan, this is Andrew. I think we talk a lot about new markets and there's really 2 major categories there, the ones that are, have been in the schedule and selling for 1, 2, 3 years now and then like even in the third quarter, there's 20 where we've actually have no real history on as well. I think what I'm -- what we're saying here is, number one, that the ones we have started and invested in, continue to ramp quickly and do well at the portfolio, and speaking with Shane and his team just the other day, and we're seeing good, encouraging build up on a lot of the new markets. So I think there's just a real -- just to get really clear, so there's no confusion that there is -- what we're trying to say is that the standard new markets and growing, we feel very good about our new markets, but we're also in the legacy Virgin America network seeing real pressure in a good chunk of their network, which a lot of it is close-in pricing and some other things going on. So as a portfolio going forward, we still feel very good about our new markets and how they're building, and we will make adjustments down the road if we need to.

Susan Marie Donofrio - *Macquarie Research - Senior Analyst*

Okay, and then just shifting, just your operations. I know you have made some comments about ATC issues and you're kind of working on readjusting some of the schedules, where are you with that?

Benito Minicucci - *Alaska Air Group, Inc. - President of Alaska Airlines Inc and COO of Alaska Airlines Inc*

Good morning, Susan, Ben Minicucci here. We're working hard. So what we've done is we've got a huge initiative with our flight ops team to really understand all the ATC. We have new issues in Seattle, of course, with some of the capacity. We're really understanding San Francisco and LAX to a certain extent. So we're working with the network team, trying to make sure our flight schedule, the volume we're putting in at times of day, day of week make sense for us to achieve a certain operational reliability and customer satisfaction. So we're working through that. We're learning. I would say is, we're not where we want to be, but we're learning what the challenges are with ATC. We're going to try to develop the best operational performance with the best network and -- that we can get from this, so it's still work in progress.

Susan Marie Donofrio - *Macquarie Research - Senior Analyst*

So you would expect to maybe start rolling that out in 2018, in terms of adjustments to the schedules?

Benito Minicucci - *Alaska Air Group, Inc. - President of Alaska Airlines Inc and COO of Alaska Airlines Inc*

We did rollout in chunks. What we're doing is, we're just rolling out in chunks. As you grow, we got to figure out where the growth comes, and you've seen us rolling out in increments over '18 and even into '19 as we make (inaudible). Because honestly, we're working with the FAA as well in Seattle, to make sure we get as much throughput out of Sea-Tac as we can get. So what we want to do is get Sea-Tac to actually operate better than it is today. So we've got to work with several agencies to make sure that happens.

Operator

Your next question comes from the line of Kevin Crissey with Citigroup.

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

Thanks for the time. Maybe for Andrew. Can you talk about the close-in pricing? You've been pretty clear about what it is, but maybe you talk about why close-in as to opposed earlier in the booking curve you would see pressure? Maybe you can't speak for others I assume, but generally, why do you see that occur?

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

Kevin, this is Shane. I think that's a fair question, and you're right. I think you'd have to sort of ask other folks about why they might be doing it. But we -- the thing -- the point we want to just sort of get across is, we haven't seen a fundamental change in demand. So we came into the month where we thought we would be from an advanced load factor standpoint, the bookings materialize close-in, just as we kind of we thought they would. They just came in at lower price points, which were by and large brought by others, and I'd really -- hard for me to speculate as to why they would've -- other people would've done that.

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

It's a challenge for us, maybe this is more of statement more than it is question, but maybe a question will come out of it. It's bad enough when this industry is kind of supply and demand is seen as commodity. This is like worse than a commodity, the demand is strong, the supply is decent and the price is actually worse than you'd expect, so it's hard for investors to take this industry and say it's a good industry and an improved industry when these are the types of results we get, so. Maybe I'll move onto another question. The question would be, relevance mattering, I can understand that having been at JetBlue, that certainly a philosophy that they had there. Can you talk about the speed of getting to that relevance? It seems that the airlines that run into kind of pricing pressures often when there's really rapid growth, so what was the urgency to grow so quickly, to create that relevance? Can you -- is it a first mover advantage? Why does speed to market matter?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

No -- people might have different philosophies, but I'm a simple man and it's really simple. We came out there and just put it all on the table, set it out, guests knew where we were going, our investors should know where we're going, our employees know where we're going and the executive team knows where we're going and that's what we've put out today. So we have a clear mandate, we have a great foundation, we're going to go. We weren't going to do this over X years or if we just want to get it done. Behind us as Brad said, and get really good at what we do best.

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

Yes, and Kevin, it's hard to ask for somebody's loyalty if you can't take them where you need to get them. And as a reminder, San Francisco, as an example, we've done, in the last 2 years, from being able to serve 11% of the customers there to 70%. So I think it was the right -- there's no question in my mind it was the right thing to do, but we've got some growing pains. To your first question, like why -- you've got strong demand, no growth in capacity and fare pressure, it's a great question. I sort -- I personally think it's jostling around, the sort of competitors compete for a position in the marketplace. And I -- as what I've seen over my career is, that just settles down in time. It settles down on the ones that do have competitive advantage, they operate well, they've got great employees, great service, great cost structure, great fare structure, they survive, and I think we're going to survive, but that's what we're going through right now.

Operator

Your next question comes from the line of Joseph DeNardi with Stifel.

Lavanya Sareen - *Alaska Air Group, Inc. - MD of IR*

Let's go to the next analyst.

Operator

Your next question comes from the line of Dan McKenzie with Buckingham Research.

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

Andrew, if I can go back to the transcon and intra-California pricing pressure, to just ask this a little differently, what percent of the revenue is being impacted by basic economy pricing in the third and the fourth quarters, is it the 25% stat you shared or is it something higher? I guess, that's the first question. And then second of course, I don't expect you to tell me what you're going to do, but are there steps that you can take to put fences around from the ULCC pricing?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

And I'm going to let Shane answer that one.

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

Good question on the percent. Basic economy is pretty much rolled out, more or less throughout most of our systems, certainly throughout California. I mean, there are a few markets here and there where it's filed, but not selling a lot. But I think most markets now, we at least see it in the sort of 21 AP range. We have seen it come in to some of the close-in pricing. I don't have the exact percentage but it's broader than it was before. That was the first question. The second question...fences, yes, I think that's a good question. Look I, I think a lot of these fare types have been practically gated out of agent like corporate sort of travel portals. In terms of indirect distribution, I do think there's a question here for OTAs. I think they put these products on the shelf, which, in general, people don't like them a lot right next to our product and consumers may not know that there's an actual difference in -- we've been sort of taking our associate partners to task over that, and I think they actually need to help do a better job, inform customers. People at the same price would prefer our product generally, because they have more stuff included.

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

I actually may circle back after the call with maybe a couple of thoughts. But I guess, Andrew or Shane, I guess, another question here. I think the rule of thumb on RASM when it comes to the new flying, historically has been around sort of 80% of system RASM and please correct on that, but my question really is, what did you see in the third quarter? Was it coming in, and I'm not talking, just intra-California, transcon but just all, kind of 44 new markets here, is it coming in at 30%? And what percent of the capacity is in the markets that are 12 months or less here in the fourth quarter?

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

So for Q3, the new markets, it's 6% of our capacity, it's all of our growth basically for Q3. Your stats are almost exactly on. Generally, those are the numbers that we would look at. We would look at a year 1 ramp that gets to about 80% of the region's average, so we break our network into 13 regions, and they were below that in Q3 which we would have expected because we started them in Q3, so we have all these outbound -- or the returns of the initial outbounds have nobody on them, but they were in 65-ish to 70% range, and they're moving up.

Operator

Your next question comes from the line of Darryl Genovesi with UBS.

Darryl Genovesi - *UBS Investment Bank, Research Division - Director and Equity Research Analyst*

Brad, you provide some commentary on having most of the merger integration stuff wrapped up by middle next year, you've got a big pilot contract to address next year. And looking beyond, you've also got some, I think you've also got some other labor cost pressure outside the pilots. Just wondering, I mean, from where you guys sit today, do you feel like you will be able to resume EPS growth in 2019, because it seems like 2018, it seems like you're going to have a hard time growing earnings, growing EPS next year, but I mean, just looking out to 2019, the way you guys sort of see your labor cost developing, assuming kind of status quo, economic -- macro-economic environment, I mean, is there -- was there an opportunity to actually resume earnings growth in '19?

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

Darryl, we sort of have a proud tradition of not talking about time periods that far out. But I would say is that there a lot of dislocation that right now, that we've discussed. We are sort of consumed with getting the merger done. We're having a fair bit of cost pressure right now. We're, as we enter some of these new markets, we're getting pushed back, that's affected some of the fares. I do see -- I do think we're in a transition period now, and I sort of see some choppy water getting better as we look forward. It's probably -- we don't know, fuel, the economy, a lot of things we don't know about 2019, so it's probably not smart for us to make a lot of estimates about -- that's something you guys are probably better positioned to do than us. But I think this firm, this company, is going to be, through our transition, we're going to settled down and operating. We'll be in a much, much better place by honestly, the middle of next year.

Darryl Genovesi - *UBS Investment Bank, Research Division - Director and Equity Research Analyst*

Okay. I mean, you had to kind of characterize the labor pressure that's still to come, beyond what you say on the pilots. Would you say overall, it's kind of more significant than what you're going to see on the pilots in the aggregate, or less significant than what you'll see from the pilots in the aggregate?

Benito Minicucci - *Alaska Air Group, Inc. - President of Alaska Airlines Inc and COO of Alaska Airlines Inc*

Darryl, it's Ben Minicucci. While for '18, we have one contract that's amendable, and from '19, there are 3 coming open. I guess what we'll say is, our philosophy has been, -- it's going to be consistent, just like it's been with pilots, and unfortunately we're in arbitration. But we have a principle on being a low-fare, low-cost, high-growth airline. And that dictates having a certain cost structure and a labor cost that needs to be consistent with that. That's going to be our strategy going in. The market will dictate where that lies, but that's going to be our strategy going in. So it's hard for us to predict how much pressure is going to be around there, but I'm just telling you, that's our mindset going in with every labor contract.

Operator

Your next question comes from the line of Rajeev Lalwani with Morgan Stanley.

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

Just coming back to the comments around developing markets going into next year, can you maybe talk about, or quantify what the opportunity is around it? Maybe just quantify what the headwinds were this year, just from having that much in the system.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

Rajeev, I think -- I'll answer this more generally, and that is, and you heard Brad's remarks around the integration. But with our partners now have 46 wide-bodies a day, departing San Francisco and Los Angeles globally, all that traffic and all the rest that will come on, we'll get a share of that as we work together. As we put in Premium Class and reconfigure aircraft, as we grow the loyalty program, as we mature the markets, as we get better with revenue management and as we tweak the schedules going forward, I think what I -- the way I would answer that to say is, we see only -- I only see upside in all the things coming together, single reservation systems, Premium Class, getting our First Class cabin configured, densifying our aircraft, building the loyalty, I just see exciting things for us going forward. And so while I can't comment on specific markets, the portfolio, I believe is going to do well.

Operator

Your next question comes from the line of Helane Becker with Cowen Securities.

Helane Renee Becker - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

I just have a couple of questions. One, when you think about the Horizon training schedule, we're coming up on the holidays, are your classes filled through that period, or will there be a pause while the holidays occur, and then resume again in the new year?

David L. Campbell - *Alaska Air Group, Inc. - CEO of Horizon Air Industries Inc and President of Horizon Air Industries Inc*

Helane, this is Dave Campbell. We are set for the balance of the year in terms of a steady flow of pilots that come into the company that are in training right now. We've pulled the schedule down to match that level. I have no concerns at all about the holiday. We've actually got a lot of help from the unions on a process called unstacking, which allows us to actually better cover the holiday periods with reserves. So I feel really good going into the holidays, both for Thanksgiving and through January 1.

Helane Renee Becker - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

I don't know who should answer this question, but I noticed that you dropped your fees on carrying odd oversize items to $25. And I'm just kind of wondering if the revenue impact is kind of just a rounding error, a. And b, the other part of the question was really with regard to OTAs, and if they don't understand your pricing, and maybe can't align with what you're doing, why don't you pull capacity out of those providers and kind of push everybody to Alaska.com?

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

Helene, this is Shane. Yes, the reduction in sort of sporting equipment is the way we sort of went out with it. Yes, it's a, it was a very, very small overall amount of revenue, and I think you got incredibly good press and play on it, and I think it's a great thing for our customers on the West Coast, people, these are near and dear into their hearts, they've got a lot of outdoors activities. We received a lot of sort of good support and response from customers on that, so we're happy to do it. On the OTA thing, it's still a large enough distributor of tickets that it probably doesn't make sense for us to just walk away from it. We're more interested in optimizing the channel and working with partners and Expedia is a very large one, they're right up the street from us, we have got a good relationship with them. Google is another one we have a really good relationship, so. We just need to get the way that they merchandise the products to be a little more clear, which is what we're working on.

Operator

Your next question comes from the line of Brandon Oglenski with Barclays.

Brandon Robert Oglenski - *Barclays PLC, Research Division - VP and Senior Equity Analyst*

Andrew or Brandon, I just want to get a point of clarification here, because my inbox is lit up with all sorts of questions on your revenue outlook here. Did you say the 4Q range is going to be better than where you were in September? Can you just remind us.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

That's what -- from what we're seen today, we're seeing it to be better than September, but we don't want to add more color to that.

Brandon Robert Oglenski - *Barclays PLC, Research Division - VP and Senior Equity Analyst*

So If I were to dissect this call, I think I heard 3 things. I'm not sure where we can place the weakness. You guys talked weaker walk-up fares and expense even though demand is okay. You talked about new markets, so I guess are maturing along the schedule that you would expect, but I guess, that did the impact your relative revenue performance here. But I guess, what troubles me, and I think Brad mentioned this earlier, you said your legacy Alaska network actually has flat PRASM but Virgin was down, was it 7% or 8%, you said Brad? I guess, when I hear that, I understand Andrew, you're talking about city presence and relevance and anything else but is there something working underneath the surface here, where guys have lost some customer loyalty at Virgin? Are you seeing book away. Because I hear the walk-up fares in California, but we're just not hearing that same pressure at some of your very closely overlapping peers? So is there something else going on at Virgin right now?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer and EVP*

No, as I shared, and I don't want to go on to details, but our loyalty growth is, very, very strong. And again, the whole premise here is that we've bought this huge base and we have nothing but improvements that we'll be making to that across every major commercial lever. And I think what you're seeing, just to be putting it bluntly here is, the industry is reacting to our new reality here in California, and that's what we have.

Operator

Your next question comes from the line of Joseph DeNardi with Stifel.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

I guess, at the Investor Day, you guys gave the revenue synergy target of $240 million. The problem with that number a little bit is that as fares come down, that most revenue synergy buckets would also come down, the one that doesn't is the credit card program. So can you just talk about, I guess, this is for Brandon, the process of realizing the incremental earnings from the credit card. Is it just a simple as bringing Virgin customers over to the Alaska card, or you do actually need to, kind of go to BofA to renegotiate? Just talk about how that works and maybe what the incremental earnings are expected to be next year?

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

No, it's not a matter of renegotiation at all. We're actually satisfied with our contract with BofA right now. It's a long-term deal, so we have no plans to go out right now and to renegotiate that deal. Although I would say BofA has been really helpful and we expect them to continue be helpful, providing incentives for us to attract members to the Alaska Airlines credit card. We do have a process going right now to get people from the Virgin America card over to the Alaska card, but it's more than just conversion. It is growing that credit card presence in California. We gave you some information at Investor Day that even with small penetration, the economics are going to be powerful. I'm not going to give you any, earnings or EPS number in terms of what that means, but what we will say is that the credit card as you well know, is a strong driver of cash flow and an economic engine in this company and we would continue to see that as being an opportunity as we grow the base.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

Okay, fair enough. And then Brandon just I guess, kind of on top of that, on Page 4, you guys provide your income statement and you kindly breakout freight and mail revenue. I don't really think anybody cares about freight and mail revenue. Would it make more sense to break out the commission revenue that you received from the card instead of that, so investors has something to look at as -- and quantify the benefit of the loyalty program.

Benito Minicucci - *Alaska Air Group, Inc. - President of Alaska Airlines Inc and COO of Alaska Airlines Inc*

This is Ben. I think our cargo forwarding (inaudible) Alaska Airlines for all our cargo employees out there.

Brandon S. Pedersen - *Alaska Air Group, Inc. - CFO, EVP - Finance, CFO - Alaska Airlines Inc and EVP - Finance - Alaska Airlines Inc*

That is really hard, Joe. It's a fair point just to evaluate what the classification is in front of the P&L. What I would tell you is, is that we get plenty of detail on the footnotes and so you'll have to wait 2 weeks to get that.

Operator

And your last question comes from the line of James Baker with JPMorgan.

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

Just a quick follow-up, and you sort of touched on this earlier, but how confident are you that the close-in weakness isn't related to the advent of basic economy at the competitive level, and does this cause you to rethink your strategy at all, in regards to that product?

Shane Tackett - *Alaska Airlines, Inc. - SVP of Revenue Management & e-commerce*

Jamie, this is Shane. Yes, confidence -- right now we're watching basic really closely. I don't think that's the principal driver and we'll continue to monitor that -- if that changes.

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

All right, everybody. Thanks very much, we look forward to speaking -- we look forward to seeing you guys out and about or talking to you on our fourth quarter call, which is coming up in 3 months. 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.