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ALK.N - Q4 2022 Alaska Air Group Inc Earnings Call

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OVERVIEW:

ALK reported 4Q22 revenue of $2.5b, GAAP net income of $22m and adjusted net income of $118m. Expects 2023 revenue to be up 8-10% and EPS to be $5.50-7.50.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Alaska Air Group 2022 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, Emily Halverson.

Emily Halverson - *Alaska Air Group, Inc. - VP of Finance, Controller & Principal Accounting Officer*

Thank you, operator, and good morning. Thank you for joining us for our fourth quarter 2022 earnings call. This morning, we issued our earnings release, which is 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 fourth quarter GAAP net income of $22 million. Excluding special items and mark-to-market fuel hedge adjustments, Air Group reported adjusted net income of $118 million. As a reminder, our comments today will 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, Emily, and good morning, everyone. Despite another volatile year, we closed out 2022 with solid results. With our continued focus and the incredible dedication of our employees, we are well positioned to build on this success as we move into 2023 and beyond.

This year, we generated full year revenue 10% above 2019 levels, doing so on 9% less capacity. Our 7.6% full year adjusted pretax margin led the industry, proving that our business model is resilient. Air Group's pretax margins have now ranked #1 in the industry for 11 of the last 13 years.

Additionally, our employees earned the largest performance bonus payout in our company's history on average, adding 10.5% on top of our employee salaries or nearly 6 weeks' worth of pay. Our people did a fantastic job delivering care, and I want to thank all of them for the work they do to ensure Air Group outperforms even during turbulent times.

Earlier this year, we identified 3 key priorities to strengthen our competitive advantage and prepare for future growth. Our teams delivered on each of these priorities, including:

One, completing our labor deals. We signed 5 labor contracts in 2022, all of which include significant improvements for our people and create stability and clarity for our company and employees. With these in place, we are well positioned to fully focus on our future.

Two, fortifying our operational reliability. Despite challenges throughout the year, we finished 2022 with one of the industry's best completion and on-time performance rates. Operational integrity is the foundation of a healthy airline, and we remain focused on balancing our growth aspirations with consistent delivery of the operational excellence Alaska is known for,

And three, executing our single fleet transitions at both Alaska and Horizon. On January 8, we flew our last A320 revenue service flight, and today marks the final Q400 flight, leaving only 10 A321s in the fleet through year-end. We have retired over 60 aircraft in the last few months, paving the way to more cost-efficient and productive operations in both our regional and mainline business.

As we kick off 2023, we're taking with us many lessons learned. We closed out a solid year, and we are committed to make 2023 even better. Our leadership team has a clear set of strategic initiatives that will support our growth aspirations, expand margins and improve operational excellence. For the full year, we expect to achieve adjusted pretax margins of between 9% and 12%. This morning, we introduced an earnings guide of $5.50 to $7.50 per share, which implies restoration to 2019 EPS levels at the midpoint.

Delivering on these targets will be challenging and will require us to leverage our competitive strengths. Undoubtedly, there have been structural shifts within the industry, but history has proven time and again that cost discipline and a strong balance sheet are required to win in the airline business. This is the heart of Air Group's DNA, and we continue to believe low costs and high productivity matter and that pursuing both benefits all stakeholders.

Productivity is not where it used to be in this post-pandemic era, and it can be debated what is structural and what is temporary, but our leadership team is dedicated to driving down unit costs in 2023 as we restore flying and begin to close the productivity gap. This strategy is largely enabled by our single fleet transition and the upgauge benefits that come with our new MAX fleet.

Two critical factors to successful capacity growth in 2023 will continue to be staffing and aircraft availability. We had success in hiring nearly 8,000 people in 2022, and are confident in our plans to hire 3,500 more in 2023. And as it relates to aircraft, we remain in close communication with Boeing and have a high degree of confidence in our fleet planning assumptions as well. Having factored in the appropriate buffer in both these areas, we are confident in our 2023 plans to grow 8% to 10% versus prior year, so long as demand and the economic environment continue to support it.

Lastly, the revenue road map we outlined at our March Investor Day will provide valuable contributions in 2023 and continue to build to our $400 million target. Through focus on cost discipline and growing revenue opportunities, we have a tangible path to expand margins, and our team is excited to deliver on these in 2023.

To wrap up, our goal throughout the pandemic has been to emerge a stronger, more competitive airline and the steps we've taken to date ensure we're on that path. We have the people, the resources, the knowledge, and the discipline to drive performance. I am proud of the results we achieved in 2022, but even more so, I'm looking forward to the opportunities ahead of us as we deliver on our financial and strategic initiatives in 2023 and beyond.

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. My comments today will focus on our fourth quarter and full year results, along with first quarter guidance. Fourth quarter revenues totaled $2.5 billion. That's up 11.3% versus the fourth quarter of 2019, notwithstanding our capacity was down nearly 10%. These strong results included the impact of severe winter conditions that we experienced over the peak holiday travel period in December. The storm reduced revenue by approximately $45 million. Notwithstanding this, we achieved unit revenue increases of 23% for the quarter with robust loads, which exceeded 2019 levels and came in at 85.5%.

More impressively, as Ben mentioned, our full year revenues came in at $9.6 billion, and that's up 10% versus 2019 on 9% less capacity. This resulted in industry-leading full year unit revenues, which were up 21% versus 2019, capping off a strong year of outperformance and demonstrating the leverage of our commercial initiatives, power of our network and a constructive pricing environment.

Turning to product and loyalty. As has been the case all year, we continued to benefit from strong demand in our premium products. First Class was up 19% and Premium Class up 14% versus the fourth quarter of 2019, with paid load factors up 6 points and 2 points, respectively. As we reflect on the full year of 2022, we were able to drive an increase in Premium revenues of nearly $0.5 billion or 20% above 2019.

Our loyalty program has also been significant revenue driver given our renewed credit card deal with Bank of America. Cash remuneration from the bank was up 42% versus the fourth quarter of '19 and 39% for the full year. As a reminder, product and loyalty represented roughly half of our $400 million commercial initiatives, and we expect to achieve product and loyalty's full run rate in 2023.

Regarding network and alliances, we are encouraged by the results we've seen through our partnerships and oneworld. Through increased opportunities that we simply did not have before the pandemic, including joint contracting with American and working with Amex GBT, we have meaningfully improved our corporate share gap and continue to experience higher traffic volumes facilitated by our alliance partnerships. And we are stepping up our airline partners selling capability in 2023, which will have us offering full partner inventory for 10 global carriers on alaskaair.com by year-end. These partners include American Airlines, IAG, Japan Airlines, Qatar and Qantas. An expanded global network that we can sell and market as our own is compelling for our guests, and we expect our airline partner revenue to reach 8% to 10% of total Air Group revenues by 2025.

Turning to corporate travel, we experienced a softening in bookings during the fourth quarter from those in the late summer peaks, exiting 2022 at approximately 75% recovered on a volume basis and 85% recovered on a revenue basis. West Coast business remains less recovered, which is not surprising given the significant workforce reductions happening across large technology companies located up and down the coast, where we primarily operate. Despite the choppiness we've seen in this segment, business travel has trended in a positive direction in the last few weeks. While we don't expect continued recovery to be linear, over time, we do still expect to fully restore our business revenue based on our improved opportunity set.

Looking ahead to guidance for the first quarter, we expect total revenue to be up 29% to 32% year-over-year on capacity that is up 11% to 14% as we lap weak comps when Omicron reached its peak in the first quarter of '22. Q1 is always our weakest quarter of the year, but leisure travel remains healthy and yields are holding steady.

For the full year, we expect revenue to be up 8% to 10% on flat unit revenue. Our 8% to 10% growth in 2023 will continue to focus on deepening the connections of our network while growing the Pacific Northwest and restoring California. Approximately 2/3 of our growth will be focused in the Pacific Northwest and 1/3 in California and will not be overly dilutive to our yields as much of it will be added to our strongest markets where demand exceeded supply in 2022. Importantly, 85% of growth comes from increased gauge and stage. This is the most efficient capacity growth of any year that I can recall at Alaska Airlines.

In closing, my team and I are squarely focused on 2022 as our baseline year, which represented industry-leading unit revenue and profitability, and from that base, we look forward to building an even stronger result for 2023. The economics of our renewed credit card will continue to build this year, our alliances and partnerships are set to gain further momentum as we improve our corporate share and international travel continues to unlock. Our premium seat mix and upgauging opportunities will also grow as we take 37 MAX deliveries where 22% of seats are premium. This combination drives further unit revenue momentum that we believe will be a differentiator for us going forward. I'm excited for what our commercial team is set to deliver in 2023.

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. As you heard from Ben, our full year 7.6% adjusted pretax margin led the industry and is a great result for us given how the year started and the challenges we experienced rescaling our company in the face of incredible demand for travel. We are especially proud that all of our people will receive significant performance-based bonuses in February given their achievements this year. We are looking forward to further building towards our long-term financial goals in 2023 by remaining focused on running a reliable operation, driving unit cost and productivity improvements and delivering on our commercial road map.

Turning to Q4 results and an update on our balance sheet. We ended the year with debt to cap of 49%, within our target range of 40% to 50% and still among the strongest in the industry. Debt payments during the fourth quarter were approximately $50 million. For full year 2023, debt repayments are modest, totaling approximately $280 million with $100 million in the first quarter.

Cash flow from operations totaled $1.4 billion for full year 2022 and total liquidity inclusive of on-hand cash and undrawn lines of credit ended the year at $2.8 billion, a great result, given that we continue to pay cash for our CapEx in 2022, which was one of the highest CapEx years in our history.

In addition to top of industry margins and our balance sheet strength, our trailing 12-month return on invested capital reached 9% in 2022, above our cost of capital and approaching our long-term target range. Our balance sheet strength, our cash position and our margin and return on capital results allowed us to take 2 other important steps towards the end of 2022.

First, we announced in December our plan to restart share repurchases in the first quarter of 2023, initially focused on offsetting dilution. And second, we secured an expanded order book with Boeing now having firm and option aircraft positions through the rest of this decade, given overall aircraft and engine demand and ongoing supply chain challenges, having access to positions for the next 7-plus years will, we believe, prove to be beneficial strategically as it provides us maximum fleet flexibility on great terms.

Turning to costs, in Q4, CASMex increased 24% versus 2019, approximately 1 point above our guide, driven entirely by lost capacity and incremental costs as a result of the severe winter weather in November and December. Absent this impact, our Q4 CASMex would have slightly beat our guide. Our full year CASMex and capacity ended the year within our guided ranges at up 20% and down 9%, respectively, versus 2019.

And as a reminder, we do continue to include the cost of our performance-based bonus and incentive pay programs in our unit costs. For the full year, this represented approximately 2 points of unit cost pressure versus 2019 and was materially more impactful on our unit costs than other airlines.

Our beliefs about what will drive long-term success and value in the airline industry remain largely intact and consistent with what we believed pre-pandemic. We firmly believe a strong balance sheet and low relative costs will be the ultimate drivers of business stability and success. We remain focused on and confident in both of these areas. Our balance sheet is strong and based on 2023 guides, Alaska is positioned to achieve the best unit cost result within the industry this year, helping us maintain or improve our pre-pandemic relative cost position.

Looking ahead to 2023, our current schedule has us returning to pre-pandemic levels of capacity during the first half of the year. Maintaining operational safety and reliability remains our top priority, and we will have continued modest cost headwinds as we complete the transition training related to our fleet transitions. However, we are planning for solid improvements to our overall fleet utilization and levels of productivity during 2023, and are focused on reducing unit costs on a year-over-year basis.

For the first quarter, we expect capacity to be up 11% to 14% with CASMex down 0% to 2% year-over-year. And for the full year, we continue to expect capacity to be up 8% to 10% with CASMex down 1% to 3% on a year-over-year basis.

Touching on fuel. Oil prices have moderated from 2022 levels but remain elevated. Refining spreads also remain volatile. We currently expect fuel price per gallon to be $3.15 to $3.35 for the first quarter and $3.10 to $3.30 for the full year. Our significant 2022 benefit from hedging, which was approximately $170 million will likely turn to a net cost in 2023. As a reminder, our hedging program uses 20% out of the money call options only, and our strike prices are above what we anticipate oil prices will be during the year.

Taken all together, as Ben mentioned, we expect margins to improve this year with our full year adjusted pretax margin guide of 9% to 12%. This incorporates the full structural impact of our ratified labor contracts, contributing approximately 3 points to our full year CASMex. And while we are optimistic about demand for travel this year, we are also cognizant of the uncertain economic backdrop we are operating in, and will adjust capacity accordingly this year if we need to.

One of our primary strengths over the years has been to execute our plans. In 2022, we certainly experienced volatility and some setbacks, but overall, we executed on the major components of our recovery plan and have a strong foundation to work from in 2023. We have most of our labor deals completed, we are through the majority of our fleet transition, we were one of the most reliable airlines in the industry, we've got a solid balance sheet and a great aircraft order book, and we are now focused on improving utilization, productivity and delivering on more of our commercial road map as we attempt to lead the industry again in financial performance in 2023.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today will come from Andrew Didora with Bank of America Global Research.

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

Andrew, just you got the RASM premium last year even with kind of the West Coast corporate travel not showing as much growth as other areas. Based on guides out of other airlines and your guidance this morning, doesn't seem like you're assuming much of a further RASM growth premium here. Just curious, what are you baking into your guide in terms of corporate travel recovery here in 2023? And do you think there's the opportunity for that RASM premium to kind of maintain throughout this year?

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

Yes. Thanks, Andrew. So a couple of things. I think firstly, and to your point, we did have the higher benchmark last year. If you look at the industry's guide for this year, I think we're all saying unit revenue is about flat, so we're in line with that. I do think, as I shared in my prepared remarks that we may have more upside in the corporate side than perhaps others on a relative basis, so I do see that there is opportunity there. And of course, as you're well aware, we really peak in the second and certainly, the third quarter. And again, industry capacity is not back to where it was in '19. So again, there could be upside here, but right now, we're in a pretty good place.

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

Got it. And then a question for Shane, just in regards to that kind of peaking in 2Q and 3Q. When we think about capacity and CASM for the rest of the year, do you expect these to be fairly consistent across the quarters going forward here? Or is there like any lumpiness that we should build into our models?

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

Andrew, thanks. From a capacity perspective, it's pretty sequentially modest Q4 to Q1, Q1 to Q2, Q2 to Q3, there is a step-up in the second half of the year, but it's very reasonable, I think. In terms of unit cost, I think flattish for the first half of the year, consistent with our Q1 guide, obviously, and then a little bit of momentum in the back half of the year. It's not exaggerated. It's sort of flattish first half of the year and then single-digit-ish in the second half of the year. So I don't think there's a big swing quarter-to-quarter that you guys need to expect from us this year.

Operator

Our next question will come from Jamie Baker with JPMorgan.

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

I know your pilot contract has a snap up or a me-too clause. But as I recall, it's a little complex. Can you remind us of the mechanics of that mechanism? When do look backs occur? What's the group of airlines that you comp against? And I can obviously do my own analysis, but if you have an Alaska estimate based on Delta becoming the market, I'm all ears, but we can do that work on our end.

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

Yes, Jamie, I'll give you the very complicated formula and then you guys can do the math. It's the simple average of the 4 larger airlines than us and JetBlue, and we look at it on September 1. So you can make sort of estimates about what you think the industry would have ratified by that point in time and pretty easily back into what you think the impact might be relative to the scheduled 4% downline raise.

So we're happy that we have this, by the way, in the contract. We don't want our pilots to fall behind, and we knew going first that we had to have some mechanism to make sure that we kept up with the market if it went to a different place than we were expecting.

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

Okay. Perfect, I appreciate the color. And then on oneworld, you said reaching 10% of group revenue by 2025. That's the goal you gave, right?

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

8% to 10%.

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

8% to 10%, okay. So I've always assumed that connecting revenue or alliance revenue is less profitable than local revenue. Obviously, if the connecting revenue is entirely incremental, it's highly accretive. I know -- and maybe my assumption is flawed. I know you've been really bulled up on your oneworld membership, but on a margin basis, how does that 8% to 10% compared to your core flying?

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

Well, I think -- so a couple of things. And again, just what we've seen this year, especially with American Airlines and not just international but domestically, connecting over their hubs and even some local market code share we have, we participated in American strong revenue environment as well where their corporate travelers or leisure travelers or connecting beyond need to utilize our network to help make for a better, shorter trip.

So overall, I've been very happy with the yields that have been produced. And again, as we go into this year with international travel and the proration of the strong international fares, again, from what we had last year, I think these are all positive momentum for us.

Operator

And our next question will come from Catherine O'Brien with Goldman Sachs.

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

So in December, you guys have some really unusual weather that drove the operational issues you saw not saying that preparing for an ice storm on Christmas should be the operational base case, but some of your peers are talking about the need to have permanently higher buffers to protect the operation. Do you believe that you already had the appropriate buffers in place for 8% to 10% capacity guide for 2023 and December didn't really to change anything? Some color there would be great.

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

Maybe I'll just speak to '23, and you can speak to the December event. By the way, welcome back, Catie, it's good to hear from you. I think we do have sufficient buffers in our capacity plan and our staffing plan to ensure that we're not overstressing the network. If you look at the second half of the year, once we sorted out our April issues with pilot training, we were amongst the best in the industry on both on time and completion rate.

Yes, this was a -- although it's becoming the norm because it happened last year as well. This was a pretty unique event that lasted multiple days and did ice over our aircraft here in Seattle and in Portland and actually in other parts of the Pacific Northwest. So it was a pretty unique event. And I think it's probably not -- we're not going to assume that it happens to us every single year, but we do have to build some more resiliency in irregular ops for sure.

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

Yes, Catie, it's Ben. Having done operations, you know, my whole career, I mean you can look at it a couple of ways. You can create a massive amount of buffer for an event that might not happen or you can go in with the appropriate level of staffing with some additional cushion to deal with winter events. But things like ice storms are massive events that cripple a city, and there's not a lot you can do no matter how much buffer you put in, there's nothing you can do to operate in an ice storm.

So what -- our mindset is create a robust schedule that we can operate in the peak periods or peak periods where there's -- where we're susceptible to weather, create additional buffers but it's got to be managed appropriately. So we were good, this was just a big event, and I'm pretty proud of the team and how we dug out of it and got back on track.

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

Totally understandable. I mean just seeing some of the scenes in Seattle, it definitely seems like a unique event. So maybe just one then. Great to have most of the fleet transition behind you. Can you just help us think about some of the moving pieces on the P&L for this year, underlying your full year CASMex guidance. I know you mentioned some elevated training in your prepared remarks, Shane, but anything else we should be thinking about that as go-forward might roll off, that's unique to the fleet transition at Alaska.

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

Yes. I don't think there's anything sort of major. A lot of the expenses related to returning the lease aircraft we took through special last year. So we don't expect a lot of noise this year in the P&L related to the fleet transition. The biggest cost piece is that we're completing the transition training of pilots by and large in the first quarter, slipping a tiny bit into the second quarter. But that's really it in terms of fleet transition-related specific costs in the P&L.

I don't think anything else is different than what you've seen across most of the industry. We have airport costs that remain an area of growth in terms of the P&L. I think that's consistent with the entire industry. And then certainly, labor costs have gone up structurally. And as we grow, they're going to continue to go up as we hire more people to fund that growth. But everything else looks pretty normal, I would say, in terms of trend, nothing to really point out.

Operator

And we'll go next to Helane Becker with Cowen & Company.

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

Just one quick clarification on that last point, Shane. The $120 million in the fourth quarter, then is that the end of the transition costs? Is that the way we think about that?

Emily Halverson - *Alaska Air Group, Inc. - VP of Finance, Controller & Principal Accounting Officer*

Helane, this is Emily. So the $120 million that you saw in special charges in Q4 should be most of the remainder because we've put all of our estimates in for returning all the A320s. We've done all the accelerated depreciation and other charges that we're going to take on both the Q4 and the A320s. Those aircraft actually leave our property over the next 12 to 18 months, so there could be some minor true ups that come through there. The last remaining thing that you're going to see coming through special charges in 2023 is going to be whatever we end up doing with the A321s, which are still on our books. So there will be some dollars there, but there should not be much more for A320s.

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

Okay. That's very helpful. And then just on the mileage plan. I think there was an announcement that there are new benefits that are accruing to your members beginning like I want to say around now. Maybe, Andrew, can you talk about that and how that should benefit your revenue line?

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

Yes. Thanks, Helane. So 2 things. Certainly, for our loyalty guest members, there is some really cool incremental benefits as it relates to bonus miles for subscriptions, boarding priorities, and even if you hold Bank of America accounts, you'll get bonuses there. So there's a lot of good things there. I think specifically for Air Group, a couple of things for new cardholders, there's going to be some minimum spend thresholds, which we've never

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had before. So I think that will add to some of the quality. And then the other thing we did have a fee increase this year, which we haven't done forever, and we're still one of, if not the lowest card membership fee. But again, that's -- that went from $75 to $95, so we will participate in that goodness.

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

Okay. That's very helpful. Just on that minimum spend, just to clarify, that -- so you're talking about it. I understand what you're saying about it being a better quality customer, but do you think that you get fewer applications because you're putting that in? Do people get turned off by that?

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

No. I think again, this is just on the forward book, Helane, not the back book. But again, obviously, this is something that we'll watch. But at the end of the day, knowing what our average card spend is and all the rest of it, our guests get a lot of value from our card and the spend on the card is very, very healthy. So we think this is well within the industry. In fact, it's probably low versus the industry, but we don't have any concerns about it.

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

And since we've launched it, we've seen a lot of credit card sign-ups, right.

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

Yes, exactly. And a lot of positive comments.

Operator

And our next question will come from Duane Pfennigwerth with Evercore ISI.

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

In terms of the pacing benefits -- the pacing of benefits of moving to a single fleet, what are we seeing in the first quarter here, if any, and can you just remind us what are the hurdles you need to clear to realize further benefits?

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

Really, it's just getting through the pilot training and getting the -9s that replace the A320s here on property. We are at low 40s of -9s relative to the 60-ish A319s and A320s we had. So the planes are coming. We've got a bunch more coming this year. We'll have full restoration of the fleet size as we get through the year. We'll be through all of the transition training on Horizon here in the first half of the year, mostly in the first quarter. Similar on Mainline, although we'll have these 10 A321s, I think we can pretty easily get those into 1 hub, 1 base and manage that.

So I think Duane, the unlock is basically going to start in the second quarter and ramp through the rest of the year, and we should be at close to full run rate as we get through the fourth quarter, dependent upon what we do with the A321 transition because we still have 150 pilots, you've got to transition off of that equipment ultimately.

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

Great answer. And then Ben, you were a -- or at least our recollection, you were a process guy historically. Historically, Alaska was very good at identifying variability, measuring variability and driving it out of your processes. Certainly, this is a different and more difficult operating environment.

But do you think you still have those opportunities to drive out variability? What are the 1, 2, 3 kind of productivity initiatives you can go attack this year? Or is that just outdated thinking from a bygone era?

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

Duane, thanks for the question. It's a great question. And we talk about that a lot. Like what I'm going to tell you is that type of thinking is in our DNA. It's been in our DNA for -- I've been here for 20 years. I mean that's how we think, and that's how we're wired. In terms of has it structurally changed, and that's -- it could be debated, but my view is that the airline industry isn't even back to 2019 levels of capacity. So if you talk about aerospace itself, now of course, you've got to have ATC staffing in place. We're not flying the same amount we're flying in 2019. So if you look at block times, if you look at departures, we're still less than we were in 2019. So the air space is essentially the same.

It's got to work from an FAA perspective. And how we look at it internally is we can still have improvements in asset utilization and people productivity. And we have already the processes and the mechanism in place to get to a better place. So is it changed a little bit? Yes. Are we going to bring it back to the left? Absolutely.

Operator

And we will move next to Michael Linenberg with Deutsche Bank.

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

Shane, congrats on getting the ROIC, I guess, congrats to you and the whole team of getting your return on invested capital trailing 12 months on better than your cost. You're one of the few out there who can actually have achieved that objective. You did highlight the return of share repurchase program. Again, this is to offset just the dilution. And then the amping up the part of the deliveries of some MAXs. Where is your thinking on bringing back the dividend? Is that something that we see in 2023? Is that later this year? Is that a next year phenomenon?

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

Mike, thanks for picking up the ROIC comment in the script. That's nice that you did. We are -- that question on dividend is a 2023 conversation item with the Board. We decided last year to prioritize offsetting dilution first. As you know, I mean, I think a dividend is something that you do when you have a lot of confidence in the outlook for a multi-year period. We're really optimistic, but we want to see how this year shapes up, especially with the economic backdrop.

So we're actively discussing it with the Board, still in our long-term sort of thought process in terms of capital allocation and shareholder returns, but nothing to say right now on it.

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

Okay. Great. Fair enough. And then just second, my question on loyalty to Andrew. To see the $1.5 billion of remuneration. And I think just a few years back, it was $1 billion, $1.1 billion. I think you had mentioned something like 39% going back to 2019. And maybe we're looking at a 10% or 12% type CAGR here. Is that the right rate going forward? I mean -- or do we see -- maybe you talked about a step-up in fee, but do we see a step up in maybe rate? Are there any sort of milestones that we hit over the next year or 2 where that $1.5 billion could say, jump to $2 billion? How should we think about the growth of that program?

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

Yes, I think -- well, a couple of things. And again, you've seen a significant step change from the new contract. And that as you heard this morning, there will be more goodness there. And there is also changes over time. But I think what we're really excited about now is we've got this behind us is, growing the program, growing the portfolio, growing the spend top of wallet, and that's what my team is squarely focused on now. And so I do personally see continued momentum, and it's going to be a very big focus for us as we continue to move forward.

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

Thanks, Mike. I did want to mention as well. That was a great answer, Andrew, because it is Andrew's birthday today, which I forgot to mention at the start. And I just want to ask the analysts not to be too hard on Andrew during the -- I'm kidding. You can be as hard on the him as you like. Happy Birthday Andrew.

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

Thank you, Ben.

Operator

And our next question today will come from Savi Syth with Raymond James Financial.

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

And I guess as a follow-up on Andrew Didora' question and it's probably a question to Andrew, so I apologize if this is mean. But I was kind of curious if you could give a little bit more color on the kind of the business recovery in terms of -- you mentioned may be getting -- eventually kind of getting back to 2019 levels, but because you have some of these other initiatives that should help you get there. Do you get there this year? And particularly, I guess what I'm focused on is you have a lot of headlines about kind of job cuts and kind of the West Coast based tech companies and -- is that having any incremental impact on the tech business demand? Or is that -- is it just more -- you're not seeing the recovery yet?

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

Yes. Savi, thanks for that. And I think it's a great question because the first thing I will say is that even though the headlines are recent on these job cuts, we've been experiencing especially some really large tech companies, their corporate travel has already been severely depressed for some time now. So the corporate numbers that you see from us already include a lot of high-tech companies with that already, in some cases, nearly turned off their travel, but have severely depressed.

So as we move forward, I don't think these cuts personally impact the technology side because I think we've already seen them. And the question is, will they come back? I'm more bullish and confident certainly on the non-tech side of corporate travel and continue to share there. I will say the jury is a little bit out on where tech does go. But I think overall, portfolio-wise, business is somewhat stable at the 85%, 75% - 85% range. But again, I hope with our share movement and continued strength over time that we do get back there.

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

And Savi, I might just add, the one thing not to lose sight of is these tech companies while they haven't been traveling for quite a while, these are like the most valuable companies on earth. And at some point, they are going to expand again and they're going to get traveling again. So it's probably future goodness for us. We just don't know when it's going to really come back. It could be a year away or more.

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

Makes sense. And I just thought of the -- getting back to the utilization and productivity, trying to understand, again, Ben you talked about the air space is what it is, and we're still below and yet you're seeing everybody struggling with and then questioning if we get back to kind of the previous productivity, what's kind of controllable on Alaska's side and the timing around that versus what's kind of out of your control?

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

No, Savi. Just let me start with a couple of things. I think for us, well, coming back from a pandemic and getting the inertia up for the operation, I think that's where not just Alaska, but the entire industry struggled getting back up to a certain level of capacity. So there was some -- there was a lot of issues there. Like as I look forward now into 2023, when I look at the benefits of single fleet and having the majority of your fleet Boeing and the majority of your fleet Embraer 175, that just drives massive efficiency in terms of crews, in terms of swapping airplanes and getting reserve crews. So just there alone for us is a major improvement.

Secondly, again, getting through a little bit of the volatility with staffing and training, that goes away. So that volatility goes out. So our focus is purely in every part of the operation where we see volatility in staffing, where we see volatility in performance is to go and zero in on those issues and snuff them out. And I mean that's what good airlines do and operational reliability is just critical in doing that right. Now, there will be things that will never go back to the way they were in 2019, but I think a lot of this is in our control. And we just don't give up on those type of things. It's savings that you can go after, and we're going to go after them.

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

Just to clarify, but just on the staffing side, staffing and training. The training is related to the fleet transition, right? Are you fairly caught up in just being able to source the pilots for the capacity?

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

Right. Yes. We're going through a lot of the A320 Airbus pilot transition right now. So we'll be through it by the end of the first quarter And so that's going through all our schoolhouse right now. Same thing with the Q400s and the Embraer 175. So we'll be largely done that big bow vvvvvv wave.

Operator

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

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

I just want to go back to the revenue guide. So it looks like RASM decelerating from -- when I look versus '19, decelerating from fourth quarter to first quarter and then reaccelerating the rest of the year. Just help us understand that. Is that a market view? Is that something specific to you guys? Just any color there.

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

Yes, Scott. So a couple of things, and we've talked about this before, obviously, but our first quarter is always the weakest. And a little bit business travels certainly in January has been highly choppy and did not return as much as we had hoped. But I think if you take a step back and look at our revenue in general, and you even go back to 2019, our unit revenue guide for the first quarter are right in line with the industry's unit guides. And they also have very big international travel coming back, which I think will be a big tailwind for them. And again, for the year, we're about right where our industry is. But again, for us, we've got work to do again on January and February on the network side. We do need to make sure that we construct our network to handle these lulls in our demand. But again, March and forward is very solid.

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

Okay. And then, Shane, I think you said that there's a fuel hedging loss embedded in the guide for this year. Just -- how much is that -- maybe just bigger picture, like the issue has been crack spreads not so much crude. Like any thoughts on revisiting how you guys hedge? I know it's more complicated, but it seems like it would be a much more effective way to hedge if you want to hedge it all.

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

Scott, it's Nat Pieper. Thanks for the question on fuel. I think first on just our hedging program. We started this 20% out of the money calls, very straightforward, formulaic, back in 2015, broke even basically 2015 to 2021. And then as you cited, and as we said in the script, 2022 it turned out to be a profitable thing. But as you know, we're not hedging to make money. We're hedging just to eliminate volatility. We think it's a good way to use our strong balance sheet and it just gives us some better insights in our planning as we move forward. We have spent a considerable amount of time with investment banking friends back on the East Coast about ways to potentially to hedge the crack spread, you're right, and that that's been the main source of frustration, volatility, et cetera. And something we're looking at. But I'd underscore, we're only going to do it if -- again, it's consistent with our core values as a company, use our strong financial foundation and just keep it on autopilot.

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

And what is the hedge loss, though you've got factored in?

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

We're looking at about $10 million in the first quarter. And then as you can imagine, it snaps to something different every day, the forward curve moves.

Operator

And our next question will come from Dan McKenzie with Seaport Global.

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

The question is the state of California was pretty slow to come out of the pandemic, and I guess my question is, what percent of the revenue growth this year is just simply getting markets back to 2019 levels of revenue? And then related to this, what percent of Alaska's revenue touches the state of California?

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

Yes. So just on the big picture, Dan, our growth, 2/3 of it is going to be Pacific Northwest and 1/3 of it is going to be California. Just as it relates to recovery, if you look at our growth in 2023, the Pacific Northwest is now in the double-digit territory higher than 2019. But California was still down 23% last year, and it will be close -- it will be 10 points better than that. So our California network will still be down about 10 to 12 points this year versus '19, but recovering. And I would say, again, very high level, 1/3 of our revenues is somewhat tied to California.

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

Wow, that's big. On the prior comment that Alaska has more upside on corporate revenue versus peers. So I guess on Premium revenue, I believe the stat was to have 62% more Premium seats this year versus 2019. And I guess I'm wondering if that stat is still correct or if that's right. And I'm not sure if you can share what the mix is today or -- but what it is today versus where you might expect to exit the year, but if you can, that's helpful.

And then related to this, just the corporate travel budgets, are they coming in a little higher than last year, a lot higher or lower just given the tech exposure.

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

Yes. So I think a couple of things. And you maybe saw in my prepared remarks that we were able to increase our Premium revenues by nearly $0.5 billion. And as Shane has shared, we're sort of trading out 12 first-class seat - 320s for 16 first-class seat MAXs. So there's real upside there. I think -- overall, I think first class revenues were up about 21%. So there is a significant opportunity there.

The other opportunity we're working on then is our regional fleet, and we -- actually we're all 175 now, which have First and Premium, and we're really happy with the progress we've made on filling those seats at good fares, and we continue to work that. And then on the last question you had was on corporate. Could you repeat that one again, sorry?

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

Yes, the corporate budget is a little higher, a little lower or given the tech exposure.

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

Yes. I think some of the budgets when I last spoke to my team was still being finalized for this year. I think -- budgets or no budgets, I think what we're really seeing a little bit here, Dan, in some cases, is the on-off switch. You've got to go to your Vice President to ask for travel, and so people are not going.

So we either see very deep cuts in travel or more to the average mean. So I think the real question is, will high-tech start to give permission for their people to start traveling again. And as you know, it's not just -- it's hotels, it's cars, it's air fares. So anyway, that's where we're at.

Operator

Our next question will come from Conor Cunningham with Melius Research.

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

Just on the capacity outlook, this would be an easy one. Just can you provide some context on what's new versus core, utilization, stage, gauge. It just feels like a lot of the growth is going to be utilization gauge base this year within your core markets, but if you could just clarify that, that would be great.

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

Yes, I mean, you're exactly right. At the end of the day, very, very few new cities. This is essentially all core restoration and 85% of all of our growth is stage and gauge. So it's a very efficient growth.

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

Is that mostly on the Pacific Northwest in California? I mean, I feel like you mentioned that in the prior...

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

Yes. Yes, that's correct.

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

All right. And then I hate to ask a cost question because I know you got a bunch, but it seems like there's some confusion. Just prior to the 1Q CASMex guide, I would have thought first half versus second half would just look a lot different than it kind of seems like it's shaping up to be.

And when I think about high level, second half benefiting from just easier comps, fleet transition, improved productivity, all that stuff, maybe the offset is more on like profit share accruals and then another increase in pilot. I'm just struggling with the idea, like are you being ultraconservative? Or is it just -- there's just a lot of uncertainty right now on the second half cost side?

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

Thanks, Conor. I think if you're implying that you might have thought it would be down more in the second half. I'm not sure if that's what your sort of question was but...

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

Yes, yes, yes.

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

There is not -- Okay. Got you. Yes. There's not a lot of noise, as I think Catie had asked earlier, sequentially throughout the quarter. I will say like with respect to our profit-sharing accruals, we had a very significant result in Q4 2022 because of our First-place performance on the margin side. And while we are still anticipating to lead the industry next year, I think you'll see those accruals come in differently this year. And it's significant enough to create a little bit of noise. But no, I think, look, we need to get through the first quarter, all the transition training, make sure the planes come and we've got to make some decisions about the A321. And I think what we've shared is something we're highly confident we can get to. We tend to target internally to do a little bit better, and that's what we're going to drive towards.

But there's a lot of year ahead of us, a lot of execution to do. And I think the last couple of years, we've been ambitious in our plans and had a lot of setbacks. We don't anticipate those this year, but I think some of that's informing some conservatism in our capacity and other guides.

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

Sorry, just 1 clarification. I mean you did have like the lease return expense in the first quarter of last year, is it maybe that. I'm sorry, I'll take it offline. I'll ask...

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

Yes, yes, we're happy to -- I mean we're not going to obviously get into like a lot of the specific details, but we're happy to give you more color for sure, on the progression.

Operator

And our next question will come from Ravi Shanker with Morgan Stanley.

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

So another follow-up on corporate, I'm afraid, I think you said that you were -- the tech customers of yours are giant corporations and they're eventually going to come back, which I guess it's true, but then we can't be 100% sure of that kind of given the way to do business. So are you happy to wait for them to kind of come back on the corporate side? Or are you looking to maybe expand your corporate customer footprint? Maybe chase some more SMB customers? And is there anything you need to do from either a marketing or a network standpoint differently if your corporate customer base is likely to change going forward?

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

Andrew can speak quickly to the sort of composition. I just -- Ravi, one thing I'd say, tech tends to have some of the best discounts. It's sort of lower-yielding business traffic. And I think the point we were trying to make is they haven't been traveling much all of last year so, - there's not - even though you have these headlines of layoffs, it doesn't really mean that there's like another downward step in terms of their travel. And I do think they're at historically low travel volumes, they may never go back to where they were pre-pandemic. I think they're going to be above where they are today. I'm very confident about that. I just don't know when.

And then maybe Andrew on sort of pursuing SMB and other.

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

Yes. I think we'll obviously adjust. We obviously would love high tech to get back to the where they were. But at the end of the day, this is about using your channels and the timing and when we sell and when we don't sell. And I think there's just a lot of opportunity to relook about who we're selling our seats to and when and where, and we will manage through this.

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

Got it. And maybe as a quick follow-up. I mean, obviously, you guys have come a long way kind of in the last couple of years and kind of where your balance sheet is right now and with kind of the biggest boxes checked on the cost side and the fleet transition side and everything else. How are you thinking of the pace of shareholder returns or cash returns through the year maybe as your confidence in your own numbers and the cycle maybe kind of build through the year?

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

Yes. Ravi, I think -- so we announced the sort of dilution offset program. I think we've ranged it from $75 million to $100 million. We'll put a grid in place. Assuming the stock sort of price is somewhat consistent throughout the year, it should be ratable throughout the year. But we'll buy more if the stock goes down and obviously a little bit less if the stock goes up. But we'll get through the entire $100 million by the end of the year, my guess is it's fairly ratable across the quarters. And that's sort of our plan at this point.

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

Thanks, everybody. Thank you, Ravi. Thanks, everyone. Thanks for joining us for our first quarter call. Look forward to following up with anybody out there, and we'll talk to you on the second quarter. Everyone, have a nice day. Thanks.

Operator

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