ALASKA AIR GROUP INC
Form 8-K
August 18, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 8-K

CURRENT REPORT PURSUANT

TO SECTION 13 OR 15(D) OF THE

SECURITIES EXCHANGE ACT OF 1934

August 18, 2006

(Date of earliest event reported)

ALASKA AIR GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation)

1-8957	**91-1292054**
(Commission File Number)	**(IRS Employer Identification No.)**

19300 International Boulevard, Seattle, Washington	**98188**
(Address of Principal Executive Offices)	**(Zip Code)**

(206) 392-5040

(Registrant s Telephone Number, Including Area Code)

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (*see* General Instruction A.2. below):

¨ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

FORWARD-LOOKING INFORMATION

This report contains forward-looking statements subject to the safe harbor protection provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events and involve known and unknown risks and uncertainties that may cause actual outcomes to be materially different from those indicated by any forward-looking statements. Some of the things that could cause our actual results to differ from our expectations are: the competitive environment and other trends in our industry; changes in our operating costs including fuel, which can be volatile; our ability to meet our cost reduction goals; our inability to achieve or maintain profitability and fluctuations in our quarterly results; our significant indebtedness; our inability to secure new aircraft financing; the implementation of our growth strategy; the timing of the MD-80 fleet disposal, the market value of MD-80 aircraft, and the amounts of potential lease termination payments with lessors and sublease payments from sublessees; compliance with our financial covenants; potential downgrades of our credit ratings and the availability of financing; the concentration of our revenue from a few key markets; general economic conditions, as well as economic conditions in the geographic regions we serve; actual or threatened terrorist attacks; global instability and potential U.S. military actions or activities; insurance costs; labor disputes; our ability to attract and retain qualified personnel; an aircraft accident or incident; liability and other claims asserted against us; operational disruptions; increases in government fees and taxes; changes in laws and regulations; our reliance on automated systems; and our reliance on third-party vendors and partners. For a discussion of these and other risk factors, see Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2005. All of the forward-looking statements are qualified in their entirety by reference to the risk factors discussed therein. These risk factors may not be exhaustive. We operate in a continually changing business environment, and new risk factors emerge from time to time. Management cannot predict such new risk factors, nor can it assess the impact, if any, of such new risk factors on our business or events described in any forward-looking statements. We disclaim any obligation to publicly update or revise any forward-looking statements after the date of this report to conform them to actual results. Over time, our actual results, performance or achievements will likely differ from the anticipated results; performance or achievements that are expressed or implied by our forward-looking statements, and such differences might be significant and materially adverse.

ITEM 7.01. Regulation FD Disclosure

Pursuant to 17 CFR Part 243 (Regulation FD), the Company is submitting information relating to its financial and operational outlook for 2006. This report includes information regarding forecasts of available seat miles (ASMs), cost per available seat mile (CASM) excluding fuel consumption, as well as certain actual results for revenue passenger miles (RPMs), load factor and revenue per available seat mile (RASM), for its subsidiaries Alaska Airlines, Inc. and Horizon Air. Our disclosure of operating cost per available seat mile, excluding fuel and other noted items, provides us the ability to measure and monitor our performance without these items. The most directly comparable GAAP measure is total operating expense per available seat mile. However, due to the large fluctuations in fuel prices, we are unable to predict total operating expense for any future period with any degree of certainty. In addition, we believe the disclosure of financial performance without mark-to-market hedging gains and losses is useful to investors in evaluating our ongoing operational performance. Please see the cautionary statement under Forward-Looking Information.

In accordance with General Instruction B.2 of Form 8-K, the following information shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), nor shall such information be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such a filing. This Report will not be deemed an admission as to the materiality of any information required to be disclosed solely to satisfy the requirements of Regulation FD.

References in this report on Form 8-K to Air Group, Company, we, us, and our refer to Alaska Air Group, Inc. and its subsidiaries, unless otherwise specified. Alaska Airlines, Inc. and Horizon Air Industries, Inc. are referred to as Alaska and Horizon, respectively, and together as our airlines.

Third Quarter 2006

In July 2006, Alaska entered into purchase and sale agreements to buyout five of its nine long-term MD-80 aircraft leases as a part of its fleet transition plan. These agreements are expected to close during the third quarter of 2006. As a result, the Company is expecting to record a charge of approximately $65 million in the third quarter, although the actual charge is not yet known with certainty and could differ from this forecast.

Alaska recently reached a new four-year agreement with the approximately 3,700 clerical, office and passenger service employees and the ramp service agents and stock clerks, all represented by the International Association of Machinists. Based on this agreement, Alaska offered a voluntary severance package to employees in the top four wage-scale steps that includes cash payments based on years of service, one year of medical coverage after the severance date, and continued travel benefits for a period of time. The number of employees accepting the severance package will not be known until September 2006. However, for purposes of the forecast we assumed if one quarter of the approximately 1,400 eligible employees accept the offer, the charge would be approximately $20 million.

The unit cost impact of the above charges is summarized in the forecast below.

	Forecast Q3, 2006	Change Yr/Yr	Forecast Q4, 2006	Change Yr/Yr
Alaska Airlines				
Capacity (ASMs in millions)	6,167	6%	5,779	4%
Fuel gallons (000,000)	92.9	3%	90.2	5%
Cost per ASM as reported on a GAAP basis (cents)*	12.0	26%	11.2	(1)%
Less: IAM restructuring charge (cents)*	0.3	NM		
Less: MD-80 lease buyout (cents)*	1.1	NM		
Less: Fuel cost per ASM (cents)*	3.2	52%	3.5	
Cost per ASM excluding fuel (cents)*	7.4	(2)%	7.7	(3)%

NM = Not meaningful

Our forecast of ASM growth for the fourth quarter of 2006 has been lowered from 6% to 4% to reflect certain changes to our schedule expected late in the year.

Alaska s July traffic increased 7.3% to 1.752 billion RPMs from 1.633 billion flown a year earlier. Capacity during July was 2.116 billion ASMs, 6.6% higher than the 1.986 billion in July 2005. The passenger load factor (the percentage of available seats occupied by fare-paying passengers) for the month was 82.8%, compared to 82.2% in July 2005. The airline carried 1,674,300 passengers compared to 1,633,500 in July 2005.

In July 2006, RASM increased 6.6% compared to July 2005 primarily due to increased yields.

* For Alaska, our forecasts of cost per ASM and fuel cost per ASM are based on forward-looking estimates, which will likely differ from actual results due to the volatility of fuel prices. There are several factors impacting our estimates including, but not limited to, the volatility of fuel prices, the finalization of the IAM severance package and MD-80 lease buyouts. Fuel cost per ASM above includes our estimate of fuel hedging gains or losses that we expect to realize on settled hedges during the quarter and actual mark-to-market hedging gains recognized in July for hedges that settle in future periods. See pages 5 and 6 for additional information regarding fuel costs.

	Forecast Q3, 2006	Change Yr/Yr	Forecast Q4, 2006	Change Yr/Yr
Horizon Air				
Capacity (ASMs in millions)	955	5%	911	6%
Fuel gallons (000,000)	14.7	8%	14.0	11%
Cost per ASM as reported on a GAAP basis (cents)*	17.2	16%	18.1	5%
Less: Fuel cost per ASM (cents)*	3.3	55%	3.4	
Cost per ASM excluding fuel (cents)*	13.9	9%	14.7	7%

Horizon s July traffic increased 4.8% to 249.0 million RPMs from 237.7 million flown a year earlier. Capacity for June was 318.8 million ASMs, 2.9% higher than the 309.8 million in July 2005. The passenger load factor for the month was 78.1%, compared to 76.7% in July 2005. The airline carried 627,300 passengers compared to 610,200 in July 2005.

In July 2006, overall RASM increased by 10.5% compared to July 2005 due primarily to a nearly 12% increase in RASM for native network flying resulting from higher load factors and increasing yields. RASM for the Frontier contract flying decreased by 2.6% from July 2005 due primarily to increases in utilization and capacity that slightly outpaced revenue gains. The allocation of Horizon s ASMs is summarized as follows:

	% of ASMs	RASM change
Native Network	78%	12.0%
Frontier contract	22%	(2.6)%

* For Horizon, our forecasts of cost per ASM and fuel cost per ASM are based on forward-looking estimates, which will likely differ significantly from actual results. There are several factors impacting our estimates including, but not limited to, the volatility of fuel prices. Fuel cost per ASM above includes our estimate of fuel hedging gains or losses that we expect to realize on settled hedges during the quarter and actual mark-to-market hedging gains recognized in July for hedges that settle in future periods. See pages 5 and 6 for additional information regarding fuel costs.

Other Financial Information

Liquidity and Capital Resources

Cash and short-term investments totaled approximately $1.1 billion as of July 31, 2006.

Fuel Hedging

We are providing unaudited information about fuel price movements and the impact of our hedging program on our financial results. Management believes it is useful to compare results between periods that exclude the mark-to-market hedging gains/losses recorded on a GAAP basis and include the cash received or due on hedge positions settled during the period (although the related impact may have been recognized for financial reporting purposes in a prior period). We refer to this as the comparison of economic fuel cost , which is presented below for July 2006.

Calculation of Economic Fuel Cost Per Gallon

July 2006 (unaudited)	**Alaska Airlines ($ in millions)**	**Alaska Airlines Cost/Gal**	**Horizon Air ($ in millions)**	**Horizon Air Cost/Gal**
Raw or into-plane fuel cost	$ 77.5	$ 2.38	$ 11.4	$ 2.35
Less: gains on settled hedges*	(9.2)	(0.28)	(1.5)	(0.31)
Economic fuel expense	**$ 68.3**	**$ 2.10**	**$ 9.9**	**$ 2.04**
Add: Mark-to-market losses related to hedges that settle in future periods, net of the reclassification of previously recorded mark-to-market losses on settled hedges*	3.1	0.09	0.5	0.10
GAAP fuel expense*	$ 71.4	$ 2.19	$ 10.4	$ 2.14

* Beginning in the first quarter of 2006, the Company records all fuel hedging activity, including mark-to-market gains and losses, in aircraft fuel expense.

Alaska Air Group s future hedge positions are as follows:

	Approximate % of Expected Fuel Requirements	Approximate Crude Oil Price per Barrel
Third Quarter 2006	46%	$ 43.41
Fourth Quarter 2006	35%	$ 46.10
First Quarter 2007	25%	$ 50.47
Second Quarter 2007	24%	$ 52.33
Third Quarter 2007	27%	$ 51.70
Fourth Quarter 2007	22%	$ 55.22
First Quarter 2008	18%	$ 59.77
Second Quarter 2008	12%	$ 62.56
Third Quarter 2008	11%	$ 62.16
Fourth Quarter 2008	10%	$ 61.77

Operating Fleet Plan

The following table provides a fleet summary for Alaska and Horizon for actual airplanes on hand as of the date of this report.

	Seats	On Hand August 18, 2006
Alaska Airlines		
B737-200C	111	6
B737-400	144	40
B737-700	124	22
B737-800	157	8
B737-900	172	12
MD-80	140	26
Total		114
Horizon Air		
Q200	37	28
Q400	74	20
CRJ 700	70	21
Total		69

The following table summarizes firm aircraft commitments for Alaska (B737-800) and Horizon (Q400) by year, excluding aircraft that have already been delivered in 2006:

	2006	2007	2008	2009	2010	Thereafter	Total
B737-800	7*	14	8	4	6	3	42
Q-400	2	11					13
Totals	9	25	8	4	6	3	55

* Includes operating lease agreements for two aircraft to be delivered in October and November of 2006.

In addition to the firm orders noted above, Alaska has options to acquire 28 additional B737-800s and purchase rights for 27 more. The company expects to exercise additional options and purchase rights on B737-800 order in the future as a result of acceleration of the retirement of its MD-80 fleet. Horizon has options to acquire 19 Q400s and 15 CRJ700s.

Giving consideration to the fleet transition plan discussed above, the following table displays the currently anticipated fleet count for Alaska as of December 31, 2006, 2007 and 2008:

	2006	2007	2008
737-200	3	0	0
MD80	22	15	0
737-400	37	35	35
737-400F**	1	1	1
737-400C**	2	4	4
737-700	22	20	20
737-800*	15	29	42
737-900	12	12	12
Totals	114	116	114

* Includes options for four aircraft in 2008, which have not yet been exercised. The total also assumes Alaska will identify one airplane for delivery in 2008 for which the Company has not secured a delivery position.

** F=Freighter; C=Combination freighter/passenger

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALASKA AIR GROUP, INC.
Registrant

Date: August 18, 2006

/s/ Brandon S. Pedersen
Brandon S. Pedersen
Staff Vice President/Finance and Controller

/s/ Bradley D. Tilden
Bradley D. Tilden
Executive Vice President/Finance and Chief Financial Officer