ALASKA AIR GROUP INC
Form 10-K
February 19, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the fiscal year ended December 31, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the transition period from to

Commission File Number 1-8957

ALASKA AIR GROUP, INC.
A Delaware Corporation

91-1292054	19300 International Boulevard, Seattle, Washington 98188
(I.R.S. Employer Identification No.)	Telephone: (206) 392-5040

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1.00 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer x Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes No x

As of January 31, 2010, shares of common stock outstanding totaled 35,645,955. The aggregate market value of the shares of common stock of Alaska Air Group, Inc. held by nonaffiliates on June 30, 2009, was approximately $653.0 million (based on the closing price of $18.26 per share on the New York Stock Exchange on that date).

DOCUMENTS INCORPORATED BY REFERENCE

Title of Document	Part Hereof Into Which Document is to be Incorporated
Definitive Proxy Statement Relating to 2010 Annual Meeting of Shareholders	Part III

Table of Contents

ALASKA AIR GROUP, INC.
ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

TABLE OF CONTENTS

Table of Contents

As used in this Form 10-K, the terms “Air Group,” “our,” “we” and the “Company” refer to Alaska Air Group, Inc. and its subsidiaries, unless the context indicates otherwise. Alaska Airlines, Inc. and Horizon Air Industries, Inc. are referred to as “Alaska” and “Horizon,” respectively, and together as our “airlines.”

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information, this Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words “believe,” “expect,” “will,” “anticipate,” “intend,” “estimate,” “project,” “assume” or other similar expressions, although not all forward-looking statements contain these identifying words. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or the Company’s present expectations.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control.

Our forward-looking statements are based on the information currently available to us and speak only as of the date on which this report was filed with the SEC. We expressly disclaim any obligation to issue any updates or revisions to our forward-looking statements, even if subsequent events cause our expectations to change regarding the matters discussed in those statements. 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 to our shareholders. For a discussion of these and other risk factors in this Form 10-K, see “Item 1A: Risk Factors.” Please consider our forward-looking statements in light of those risks as you read this report.

Table of Contents

PART I

ITEM 1. OUR BUSINESS

We are a Delaware corporation incorporated in 1985 and we have two principal subsidiaries: Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon). Through these subsidiaries, we provide passenger air service to more than 22 million passengers per year to more than 90 destinations. We also provide freight and mail services, primarily to and within the state of Alaska and on the West Coast. Although Alaska and Horizon both operate as airlines, their business plans, competition, and economic risks differ substantially. Alaska is a major airline that operates an all-jet fleet with an average passenger trip length in 2009 of 1,180 miles. Horizon is a regional airline, operates turboprop and jet aircraft, and its average passenger trip length for 2009 was 356 miles. Individual financial information about Alaska and Horizon is in Note 13 to the consolidated financial statements and throughout this report, specifically in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Both of our airlines continue to distinguish themselves from competitors by providing award-winning customer service and differentiating amenities. Our outstanding employees and excellent service in the form of advance seat assignments, expedited check-in with Airport of the Future®, web check-in, flight alerts, an award-winning frequent flyer program, well-maintained aircraft, a first-class section aboard Alaska aircraft, and other amenities are regularly recognized by independent studies, awards, and surveys of air travelers. For example, Alaska has ranked “Highest in Customer Satisfaction among Traditional Network Carriers” in both 2009 and 2008 by J.D. Power and Associates and won the “Program of the Year” Freddie award for 2008 and 2007 for our Mileage Plan program. Horizon won the 2007 “Regional Airline of the Year” from Air Transport World. We are very proud of these awards and we continue to strive to have the best customer service in the industry.

WHERE YOU CAN FIND MORE INFORMATION

Our filings with the Securities and Exchange Commission, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are available on our website at www.alaskaair.com, free of charge, as soon as reasonably practicable after the electronic filing of these reports with the Securities and Exchange Commission. The information contained on our website is not a part of this annual report on Form 10-K.

OUR AIRLINES

ALASKA

Alaska Airlines is an Alaska corporation that was organized in 1932 and incorporated in 1937. We offer extensive north/south service within the western U.S., Canada and Mexico, and passenger and dedicated cargo services to and within the state of Alaska. We also provide long-haul east/west service to Hawaii and twelve cities in the mid-continental and eastern U.S., primarily from Seattle, where we have our largest concentration of departures; although we do offer long-haul departures from other cities as well.

In 2009, we carried 15.6 million revenue passengers in our mainline operations, and we carry more passengers between Alaska and the U.S. mainland than any other airline. Based on the number of passengers carried in 2009, Alaska’s leading airports are Seattle, Los Angeles, Anchorage and Portland. Based on 2009 revenues, the leading nonstop routes are Seattle-Anchorage, Seattle-Los Angeles, and Seattle-San Diego. At December 31, 2009, Alaska's operating fleet consisted of 115 jet aircraft, compared to 110 aircraft as of December 31, 2008.

Alaska's passenger traffic by market is presented below:

	2009		2008	
West Coast	36	%	41	%
Within Alaska and between Alaska and the U.S. mainland	21	%	23	%
Transcon/midcon	23	%	20	%
Mexico	9	%	8	%
Hawaii	9	%	5	%
Canada	2	%	3	%
Total	100	%	100	%

Table of Contents

HORIZON

Horizon Air Industries is a Washington corporation that first began service, was incorporated in 1981 and was acquired by Air Group in 1986. It is the largest regional airline in the Pacific Northwest, and serves a number of cities in seven states, five cities in Canada, and two cities in Mexico.

In 2009, Horizon carried 6.8 million revenue passengers. Approximately 90% of Horizon's revenue passenger miles in 2009 were flown domestically, primarily in the states of Washington, Oregon, Idaho and California, compared to 91% in 2008. The Canada markets accounted for 8% of revenue passenger miles in both 2009 and 2008. Flying to Mexico accounted for about 2% of total traffic in 2009 compared to less than 1% in 2008.

Based on 2009 passenger enplanements, Horizon's leading airports are Seattle, Portland, Boise, and Spokane. Based on revenues in 2009, the leading nonstop routes are Portland-Seattle, Spokane-Seattle, and Boise-Seattle. At December 31, 2009, Horizon's operating fleet consisted of 18 jets and 40 turboprop aircraft. Horizon flights are listed under the Alaska Airlines designator code in airline reservation systems.

Alaska and Horizon integrate their flight schedules to provide convenient, competitive connections between most points served by their systems. In 2009 and 2008, approximately 22% and 23%, respectively, of Horizon's passengers connected to flights operated by Alaska.

INDUSTRY CONDITIONS

GENERAL

The airline industry is highly competitive and has historically been characterized by low profit margins and high fixed costs, primarily for wages, aircraft fuel, aircraft ownership, and facilities rents. Because expenses of a flight do not vary significantly with the number of passengers carried, a relatively small change in the number of passengers or in pricing has a disproportionate effect on an airline's operating and financial results. In other words, a minor shortfall in expected revenue levels could cause a disproportionately negative impact on our results of operations. Passenger demand and ticket prices are, to a large measure, influenced by the general state of the economy, current global economic and political events and total available airline seat capacity.

2009

2009 was a year plagued by economic woes and the worst recession the United States has experienced since the Great Depression. The result was a steep decline in the demand for air travel, causing a double-digit percentage decline in unit revenue and passenger count across the industry. In response to this decline and the high price of oil in 2008, airlines reduced domestic capacity by approximately 7% in 2009 compared to 2008. The significant decline in the average price of jet fuel from its 2008 high helped mitigate an otherwise difficult year for the industry. In order to maximize revenue to help offset the demand decline, airlines continued down the path of adding or increasing ancillary fees for checked baggage, buy-on-board items, ticket fees, etc. These fees helped to recover some of the lost revenue from the decline in traffic, but certainly not all of it.

During 2009, our key initiative was to optimize revenue. We reduced and redeployed capacity to better match demand, and the new markets we have entered are performing well. Our revenue initiatives, combined with lower fuel costs, our continued focus on customer service and our strong operational performance resulted in financial results that significantly improved from 2008 and were among the best in the industry.

OUR REVENUE INITIATIVES, COMBINED WITH LOWER FUEL COSTS, OUR CONTINUED FOCUS ON CUSTOMER SERVICE AND OUR STRONG OPERATIONAL PERFORMANCE RESULTED IN 2009

FINANCIAL RESULTS THAT WERE AMONG THE BEST IN THE INDUSTRY.

FUEL

Our business and financial results are highly affected by the price and, potentially, the availability of jet fuel. Fuel prices have been extremely volatile over the past few years. The price of crude oil averaged over $106 per barrel in 2008, with a high of nearly $150 per barrel in July 2008. The average price in 2009 was a more moderate $62 per barrel, although that price is still historically high. For us, a $1 per barrel increase in the price of oil equates to approximately $9 million of additional fuel cost annually. A one-cent change in our fuel price per gallon will impact our expected annual fuel cost by approximately $3.5 million per year.
We refer to the price we pay for fuel at the airport, including applicable taxes, as our "raw" fuel price. Raw fuel prices are impacted by world oil prices and refining costs, which can vary by region in the U.S. Generally, West Coast jet fuel prices are somewhat higher and more volatile than prices in the Gulf Coast or on the East Coast, putting our airlines at a slight competitive disadvantage. Historically, fuel costs have generally represented 10% to 15% of an airline's operating costs, but due to volatility in prices over the past few years, fuel costs have been in the range of 20% to 40% of total operating costs. Both the crude oil and refining cost components of jet fuel are volatile and outside of our control, and they can have a significant and immediate impact on our operating results.

As depicted in the charts below, our average raw fuel cost per gallon declined 43% in 2009, and increased 42% and 8% in 2008 and 2007, respectively.

We use crude oil call options and jet fuel refining margin swap contracts as hedges to decrease our exposure to the volatility of jet fuel prices. Call options effectively cap our pricing on the crude oil component of fuel prices, limiting our exposure to increasing fuel prices for about half of our planned fuel consumption. With these call option contracts, we still benefit from the decline in crude oil prices, as there is no future cash exposure above the premiums we pay to enter into the contracts.

OUR AIRCRAFT ARE AMONG THE MOST FUEL-EFFICIENT IN THEIR RESPECTIVE CLASSES.

We believe that operating fuel-efficient aircraft also helps to mitigate the effect of high fuel prices. Alaska operates an all-Boeing 737 fleet. At Horizon, the long-term goal is to transition to an all-Q400 turboprop fleet. Because of these changes, Alaska's fuel burn expressed in available seat miles flown per gallon (ASMs/g) improved from 65.9 ASMs/g in 2006 to 75.9 ASMs/g in 2009. Similarly, Horizon's fuel burn has improved from 51.7 ASMs/g in 2006 to 54.8 ASMs/g in 2009.

These reductions have not only reduced our fuel cost, but also the amount of greenhouse gases and other pollutants that our operations emit.

MARKETING AND COMPETITION

ALLIANCES WITH OTHER AIRLINES

We have marketing alliances with several airlines that provide reciprocal frequent flyer mileage credit and redemption privileges as well as code sharing on certain flights as shown in the table below. Alliances are an important part of our strategy and enhance our revenues by:

- offering our customers more travel destinations and better mileage credit/redemption opportunities;
- offering our Mileage Plan program a competitive advantage because of our partnership with carriers from two major global alliances (Oneworld and Skyteam);

- giving us access to more connecting traffic from other airlines; and
- providing members of our alliance partners' frequent flyer programs an opportunity to travel on Alaska and Horizon while earning mileage credit in our partners' programs.

Most of our codeshare relationships are free-sell codeshares, where the marketing carrier sells seats on the operating carrier's flights from the operating carrier's inventory, but takes no inventory risk. Our marketing agreements have various termination dates, and at any time, one or more may be in the process of renegotiation.

Table of Contents

Our marketing alliances with other airlines as of December 31, 2009 are as follows:

	Frequent Flyer Agreement	Codeshare—Alaska Flight # on Flights Operated by Other Airline	Codeshare—Other Airline Flight # On Flights Operated by Alaska/ Horizon
Major U.S. or International Airlines			
American Airlines/American Eagle	Yes	Yes	Yes
Air France	Yes	No	Yes
British Airways	Yes	No	No
Cathay Pacific Airways	Yes	No	No
Delta Air Lines/Delta Connection (2)	Yes	Yes	Yes
KLM	Yes	No	Yes
Korean Air	Yes	No	Yes
Lan S.A.	Yes	No	Yes
Air Pacific (1)	Yes	No	Yes
Qantas	Yes	No	Yes
Regional Airlines			
Era Alaska	Yes (1)	Yes	No
PenAir	Yes (1)	Yes	No

(1) These airlines do not have their own frequent flyer program. However, Alaska's Mileage Plan members can earn and redeem miles on these airlines' route systems.

(2) Alaska has codeshare agreements with the Delta Connection carriers Skywest and ASA as part of its agreement with Delta. This agreement also includes former Northwest Airlines flights.

COMPETITION

Competition in the airline industry is intense. We believe the principal competitive factors in the industry that are important to customers are:

- safety record and reputation,
- flight schedules,
- fares,
- customer service,
- routes served,
- frequent flyer programs,
- on-time arrivals,
- baggage handling,

- on-board amenities,
- type of aircraft, and
- code-sharing relationships.

Together, Alaska and Horizon carry approximately 3.5% of all U.S. domestic passenger traffic. We compete with one or more domestic or foreign airlines on most of our routes, including Southwest Airlines, United Airlines, Delta Air Lines, Continental Airlines, American Airlines, US Airways, JetBlue Airways, Virgin America, Allegiant and regional affiliates associated with some of these carriers.

Due to its short-haul markets, Horizon also competes with ground transportation in many markets, including train, bus and automobile transportation. Both carriers, to some extent, also compete with technology such as video conferencing and internet-based meeting tools that have resulted in a change in business travel.

TICKET DISTRIBUTION

Airline tickets are distributed through three primary channels:

- Alaskaair.com. It is less expensive for us to sell through this direct channel and, as a result, we continue to take steps to drive more business to our website. In addition, we believe this channel is preferable from a branding and customer-relationship standpoint in that we can establish ongoing communication with the customer and tailor offers accordingly.

- Traditional and online travel agencies. Consumer reliance on traditional travel agencies continues to shrink, giving way to online travel agencies. Both traditional and online travel agencies typically use Global Distribution Systems (GDS), such as Sabre, to obtain their fare and inventory data from airlines. Bookings made through these agencies result in a fee that is charged to the airline. Many of our large corporate customers require that we use these agencies. Some of our competitors do not use this distribution channel and, as a result, have lower ticket distribution costs.

- Reservation call centers. These call centers are located in Phoenix, Ariz.; Kent, Wash.; and Boise, Idaho. We generally charge a $15 fee for booking reservations through these call centers.

Our sales by channel are as follows:

	2009	2008
Alaskaair.com	48 %	45 %
Traditional and online travel agencies	42 %	43 %
Reservation call centers	9 %	11 %
All other channels	1 %	1 %
Total	100 %	100 %

EMPLOYEES

Labor costs have historically made up 30% to 40% of an airline’s total operating costs. Most major airlines, including ours, have employee groups that are covered by collective bargaining agreements. Airlines with unionized work forces have higher labor costs than carriers without unionized work forces, and they may not have the ability to adjust labor costs downward quickly enough to respond to new competition. New entrants into the U.S. airline industry generally do not have unionized work forces, which can be a competitive advantage for those airlines.

Table of Contents

We had 12,440 (9,046 at Alaska and 3,394 at Horizon) active full-time and part-time employees at December 31, 2009, compared to 14,143 (10,250 at Alaska and 3,893 at Horizon) as of December 31, 2008. Wages, salaries and benefits (including variable incentive pay) represented approximately 43% and 40% of our total non-fuel operating expenses in 2009 and 2008, respectively.

At December 31, 2009, labor unions represented 82% of Alaska's and 46% of Horizon's employees. Our relations with our labor organizations are governed by the Railway Labor Act (RLA). Under this act, collective bargaining agreements do not expire but instead become amendable as of a stated date. If either party wishes to modify the terms of any such agreement, it must notify the other party in the manner prescribed by the RLA and/or described in the agreement. After receipt of such notice, the parties must meet for direct negotiations, and if no agreement is reached, either party may request the National Mediation Board (NMB) to initiate a process including mediation, arbitration, and a potential "cooling off" period that must be followed before either party may engage in self-help.

Alaska's union contracts at December 31, 2009 were as follows:

Union	Employee Group	Number of Active Employees	Contract Status
Air Line Pilots Association International (ALPA)	Pilots	1,253	Amendable 4/1/2013
Association of Flight Attendants (AFA)	Flight attendants	2,268	Amendable 4/27/2012
International Association of Machinists and Aerospace Workers (IAM)	Ramp service and stock clerks	733	Amendable 7/17/2012
IAM	Clerk, office and passenger service	2,387	Amendable 7/17/2010
Aircraft Mechanics Fraternal Association (AMFA)	Mechanics, inspectors and cleaners	634	Amendable 10/17/2011
Mexico Workers Association of Air Transport	Mexico airport personnel	70	Amendable 9/29/2010
Transport Workers Union of America (TWU)	Dispatchers	35	Amendable 7/01/2010*

* Collective bargaining agreement contains interest arbitration provision.

Horizon's union contracts at December 31, 2009 were as follows:

Union	Employee Group	Number of Active Employees	Contract Status
International Brotherhood of Teamsters (IBT)	Pilots	531	In Negotiations
AFA	Flight attendants	519	Amendable 12/21/2011
IBT		450	In Negotiations

	Mechanics and related classifications		
TWU	Dispatchers	16	Amendable 10/06/2010
National Automobile, Aerospace, Transportation and General Workers	Station personnel in Vancouver and Victoria, BC, Canada	60	Expires 2/14/2010

Table of Contents

EXECUTIVE OFFICERS

The executive officers of Alaska Air Group, Inc. and executive officers of Alaska and Horizon who have significant decision-making responsibilities, their positions and their respective ages (as of February 1, 2010) are as follows:

Name	Position	Age	Air Group or Subsidiary Officer Since
William S. Ayer	Chairman, President and Chief Executive Officer of Alaska Air Group, Inc. and Chairman and Chief Executive Officer of Alaska Airlines, Inc.	55	1985
Glenn S. Johnson	Executive Vice President/Finance and Chief Financial Officer of Alaska Air Group, Inc. and Alaska Airlines, Inc.	51	1991
Keith Loveless	Vice President/Legal and Corporate Affairs, General Counsel and Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc.	53	1996
Bradley D. Tilden	President of Alaska Airlines, Inc.	49	1994
Jeffrey D. Pinneo	President and Chief Executive Officer of Horizon Air Industries, Inc.	53	1990
Benito Minicucci	Executive Vice President/Operations and Chief Operating Officer of Alaska Airlines, Inc.	43	2004
Kelley Dobbs	Vice President/Human Resources and Labor Relations of Alaska Airlines, Inc.	43	2004
Brandon S. Pedersen	Vice President/Finance and Controller of Alaska Air Group, Inc. and Alaska Airlines, Inc. (Principal Accounting Officer)	43	2003

Mr. Ayer has been President since February 2003 and became Chairman and Chief Executive Officer in May 2003. Mr. Ayer is also Chairman and Chief Executive Officer of Alaska Airlines. He has served as Alaska Airlines' Chairman since February 2003, as Chief Executive Officer since January 2002 and as President from November 1997 to December 2008. Prior to that, he was Sr. Vice President/Customer Service, Marketing and Planning of Alaska Airlines from January 1997, and Vice President/Marketing and Planning from August 1995. Prior thereto, he served as Sr. Vice President/Operations of Horizon Air from January 1995. Mr. Ayer serves on the boards of Alaska Airlines, Puget Energy, Inc., the Alaska Airlines Foundation, Angel Flight West, Inc., and the Museum of Flight. He also serves on the University of Washington Business School Advisory Board, and as a director of the Seattle branch of the Federal Reserve Board.

Mr. Johnson joined Alaska Airlines in 1982, became Vice President/Controller and Treasurer of Horizon Air Industries in 1991 and Vice President/Customer Services in 2002. He returned to Alaska Airlines in 2003 where he has served in several roles, including Vice President/Finance and Controller and Vice President/Finance and Treasurer. He served as Senior Vice President/Customer Service – Airports from January 2006 through April 2007 and in April 2007, he was elected Executive Vice President/Airports and Maintenance and Engineering. He was elected Executive Vice President/Finance and Chief Financial Officer of Alaska Air Group and Alaska Airlines in December

2008. He is a member of Air Group's Management Executive Committee.

Mr. Loveless became Corporate Secretary and Assistant General Counsel of Alaska Air Group and Alaska Airlines in 1996. In 1999, he was named Vice President/Legal and Corporate Affairs, General Counsel and Corporate Secretary of Alaska Air Group and Alaska Airlines. He is a member of Air Group's Management Executive Committee.

Mr. Tilden joined Alaska Airlines in 1991, became controller of Alaska Airlines and Alaska Air Group in 1994, Chief Financial Officer in February 2000, Executive Vice President/Finance in January 2002, Executive Vice President/Finance and Planning in 2007, and President of Alaska Airlines in December 2008. He is a member of Air Group's Management Executive Committee.

Mr. Pinneo became Vice President/Passenger Service of Horizon Air Industries in 1990 following nine years at Alaska Airlines in various marketing roles. In January 2002, he was named President and CEO of Horizon Air. He is a member of Air Group's Management Executive Committee.

Mr. Minicucci joined Alaska Airlines in 2004 as Staff Vice President of Maintenance and Engineering and was promoted to Vice President of Seattle Operations in June 2008. In December 2008 he was elected Executive Vice President/Operations and Chief Operating Officer of Alaska Airlines. He is a member of Air Group's Management Executive Committee.

Ms. Dobbs joined Alaska Airlines in 1987, became Staff Vice President/Human Resources – Staffing and Development in 2004, Vice President/Human Resources – Strategy, Culture and Inclusion in June 2007, and Vice President/Human Resources and Labor Relations in 2009. She is a member of Air Group's Management Executive Committee.

Mr. Pedersen joined Alaska Airlines in 2003 as Staff Vice President/Finance and Controller of Alaska Air Group and Alaska Airlines and was elected Vice President/Finance and Controller for both entities in 2006.

Table of Contents
REGULATION

GENERAL

The airline industry is highly regulated.

The Department of Transportation (DOT) and the Federal Aviation Administration (FAA) exercise significant regulatory authority over air carriers.

- DOT: In order to provide passenger and cargo air transportation in the U.S., a domestic airline is required to hold a certificate of public convenience and necessity issued by the DOT. Subject to certain individual airport capacity, noise and other restrictions, this certificate permits an air carrier to operate between any two points in the U.S. Certificates do not expire, but may be revoked for failure to comply with federal aviation statutes, regulations, orders or the terms of the certificates. In addition, the DOT has jurisdiction over the approval of international codeshare agreements, alliance agreements between domestic major airlines, international route authorities and certain consumer protection matters, such as advertising, denied boarding compensation and baggage liability. International treaties may also contain restrictions or requirements for flying outside of the U.S.

- FAA: The FAA, through Federal Aviation Regulations (FARs), generally regulates all aspects of airline operations, including establishing personnel, maintenance and flight operation standards. Domestic airlines are required to hold a valid air carrier operating certificate issued by the FAA. Pursuant to these regulations we have established, and the FAA has approved, our operations specifications and a maintenance program for each type of aircraft we operate. The maintenance program provides for the ongoing maintenance of such aircraft, ranging from frequent routine inspections to major overhauls. From time to time the FAA issues airworthiness directives (ADs) that must be incorporated into our aircraft maintenance program and operations. All airlines are subject to enforcement actions that are brought by the FAA from time to time for alleged violations of FARs or ADs. At this time, we are not aware of any enforcement proceedings that could either materially affect our financial position or impact our authority to operate.

The Aviation and Transportation Security Act (the Security Act) generally provides for enhanced aviation security measures. Pursuant to the Security Act, the Transportation Security Administration (TSA) is responsible for aviation security. The Security Act imposes a $2.50 per enplanement security service fee (maximum $5.00 one-way fee), which is collected by the air carriers and submitted to the government to pay for these enhanced security measures. In addition, carriers are required to pay an amount to the TSA to cover the cost of providing security measures equal to the amount the air carriers paid for screening passengers and property in 2000. We paid $12.6 million each year to the TSA for this security charge in 2009, 2008 and 2007.

The Department of Justice has jurisdiction over airline antitrust matters. The U.S. Postal Service has jurisdiction over certain aspects of the transportation of mail and related services. Labor relations in the air transportation industry are regulated under the Railway Labor Act. To the extent we continue to fly to foreign countries and pursue alliances with international carriers, we may be subject to certain regulations of foreign agencies.

AIRLINE FARES

Airlines are permitted to establish their own domestic fares without governmental regulation, and the industry is characterized by vigorous price competition. The DOT maintains authority over international (generally outside of North America) fares, rates and charges. International fares and rates are also subject to the jurisdiction of the governments of the foreign countries we serve. Although air carriers are required to file and adhere to international fare and rate tariffs, substantial commissions, overrides and discounts given to travel agents, brokers and wholesalers characterize many international markets.

ENVIRONMENTAL MATTERS

We are subject to various laws and government regulations concerning environmental matters and employee safety and health in the U.S. and other countries. U.S. federal laws that have a particular effect on us include the Airport Noise and Capacity Act of 1990, the Clean Air Act, the Resource Conservation and Recovery Act, the Clean Water Act, the Safe Drinking Water Act, and the Comprehensive Environmental Response, Compensation and Liability Act, or Superfund Act. We are also subject to the oversight of the Occupational Safety and Health Administration (OSHA) concerning employee safety and health matters. The U.S. Environmental Protection Agency, OSHA, and other federal agencies have been authorized to create and enforce regulations that have an impact on our operations. In addition to these federal activities, various states have been delegated certain authorities under these federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations. We maintain our safety, health and environmental programs in order to meet or exceed these requirements.

It is expected that the current federal administration will likely move forward with legislation to reduce carbon and other greenhouse gas emissions. We do not believe legislation is necessary to motivate airlines to reduce fuel burn and, in turn, reduce emissions. For example, Alaska and Horizon have transitioned or are transitioning to more fuel-efficient aircraft fleets, thereby greatly reducing our total emissions.

Table of Contents

The Airport Noise and Capacity Act recognizes the rights of airport operators with noise problems to implement local noise abatement programs so long as they do not interfere unreasonably with interstate or foreign commerce or the national air transportation system. Authorities in several cities have established aircraft noise reduction programs, including the imposition of nighttime curfews. We believe we have sufficient scheduling flexibility to accommodate local noise restrictions.

Although we do not currently anticipate that these regulatory matters, individually or collectively, will have a material effect on our financial condition, results of operations or cash flows, new regulations or compliance issues that we do not currently anticipate could have the potential to harm our financial condition, results of operations or cash flows in future periods.

CUSTOMER SERVICE

Along with other domestic airlines, we have implemented a customer service commitment plan to address a number of service goals, including, but not limited to, goals relating to lowest fare availability, delays, cancellations and diversions, baggage delivery and liability, guaranteed fares and ticket refunds. All of our employees are required to periodically attend our Customer Experience Workshop to enhance our customer service focus and ultimately improve the experience our customers have when traveling with us.

In December 2009, the DOT adopted new rules effective in April 2010 that set fines of as much as $27,500 per passenger when airlines leave passengers on the aircraft for more than three hours while on the ground. These new rules are in response to recent incidents involving other airlines that resulted in lengthy tarmac delays. Bills have been introduced in several states, including the state of Washington, which propose to regulate airlines when operating in those specific states. However, we believe these bills would be preempted by federal law. We do not believe these bills are necessary.

MILEAGE PLAN PROGRAM

All major airlines have developed frequent flyer programs as a way of increasing passenger loyalty. Alaska's Mileage Plan allows members to earn mileage by flying on Alaska, Horizon and other participating airlines and by using the services of non-airline partners, which include a credit card partner, a grocery store chain, a telephone company, hotels, car rental agencies, and other businesses. Alaska is paid by non-airline partners for the miles it credits to member accounts. With advance notice, Alaska has the ability to change the Mileage Plan terms, conditions, partners, mileage credits, and award levels or to terminate the program.

Mileage can be redeemed for free or discounted travel and for various other awards. Upon accumulating the necessary mileage, members notify Alaska of their award selection. Mileage Plan accounts are generally deleted after two years of inactivity in a member's account. Over 80% of the free flight awards on Alaska and Horizon in 2009 were subject to capacity-controlled seating.

As of December 31, 2009 and 2008, approximately 3.0 million and 3.4 million, respectively, round-trip flight awards were eligible for redemption by Mileage Plan members. Of those eligible awards, we estimate that approximately 88% will ultimately be redeemed. For the years 2009, 2008 and 2007, approximately 1,190,000, 685,000 and 600,000 round-trip awards and 260,000, 410,000 and 250,000 one-way flight awards were redeemed and flown on Alaska and Horizon. These awards represent approximately 15.0%, 9.3%, and 7.0% for 2009, 2008, and 2007, respectively, of the total passenger miles flown on Alaska and Horizon. For the years 2009, 2008, and 2007, approximately 181,000, 214,000, and 243,000, respectively, round-trip flight awards were redeemed and flown on airline partners. In November 2008, we began charging a $25 fee for awards redeemed on our airline partners.

We also have awards that allow for redemption of one-half the mileage redemption rate plus 50% of the fare for eligible award travel. Our members redeemed approximately 730,000, 620,000, and 560,000 one-way equivalent awards under this program in 2009, 2008, and 2007, respectively.

We sell mileage credits to our non-airline partners. We defer a majority of the sales proceeds and recognize revenue when award transportation is provided.

OTHER INFORMATION

SEASONALITY AND OTHER FACTORS

Our results of operations for any interim period are not necessarily indicative of those for the entire year because our business is subject to seasonal fluctuations. Our profitability is generally lowest during the first and fourth quarters due principally to lower traffic. It typically increases in the second quarter and then reaches its highest level during the third quarter as a result of vacation travel, including increased activity in the state of Alaska.

In addition to passenger loads, factors that could cause our quarterly operating results to vary include:

- general economic conditions and resulting changes in passenger demand,

- pricing initiatives by us and our competitors,
- changes in fuel costs,
- the timing and amount of maintenance expenditures (both planned and unplanned),
- increases or decreases in passenger and volume-driven variable costs, and
- labor actions.

In addition to those factors listed above, seasonal variations in traffic, the timing of various expenditures and adverse weather conditions may affect our operating results from quarter to quarter. Many of the markets we serve experience inclement weather conditions in the winter, causing increased costs associated with deicing aircraft, canceled flights and reaccommodation of displaced passengers. Due to our geographic area of operations, we can be more susceptible to adverse weather conditions (particularly in the state of Alaska and the Pacific Northwest) than some of our competitors, who may be better able to spread weather-related risks over larger route systems.

No material part of our business or that of our subsidiaries is dependent upon a single customer, or upon a few high-volume customers.

INSURANCE

We carry Airline Hull, Spares and Comprehensive Legal Liability Insurance in amounts and of the type generally consistent with industry practice to cover damage to aircraft, spare parts and spare engines, as well as bodily injury and property damage to passengers and third parties. Since the September 11, 2001 attacks, this insurance program excludes coverage for War and Allied Perils, including hijacking, terrorism, malicious acts, strikes, riots, civil commotion and other identified perils. So, like other airlines, the company has purchased war risk coverage for such events through the U.S. government.

We believe that our emphasis on safety and our state-of-the-art flight deck safety technology help to control the cost of aviation insurance.

ITEM 1A.RISK FACTORS

If any of the following occurs, our business, financial condition and results of operations could suffer. In such case, the trading price of our common stock could also decline. We operate in a continually changing business environment. In this environment, new risks may emerge and already identified risks may vary significantly in terms of impact and likelihood of occurrence. Management cannot predict such developments, nor can it assess the impact, if any, on our business of such new risk factors or of events described in any forward-looking statements.

ECONOMY AND FINANCE

The current economic climate has impacted demand for our product and could harm our financial condition and results of operations if the environment does not improve.

The recent economic recession resulted in a decline in demand for air travel. If the economic climate does not improve and traffic does not improve as we expect, we will likely need to adjust our capacity plans, which could harm our business, financial condition and results of operations.

Our business, financial condition, and results of operations are substantially exposed to the volatility of jet fuel prices. Increases in jet fuel costs would harm our business.

Fuel costs constitute a significant portion of our total operating expenses, accounting for 21% and 36% of total operating expenses for the years ended December 31, 2009 and 2008, respectively. Significant increases in average fuel costs during the past several years have negatively affected our results of operations.

Future increases in the price of jet fuel will harm our financial condition and results of operations, unless we are able to increase fares or add additional ancillary fees to attempt to recover increasing fuel costs.

Our indebtedness and other fixed obligations could increase the volatility of earnings and otherwise restrict our activities and potentially lead to liquidity constraints.

We have, and will continue to have for the foreseeable future, a significant amount of debt. Due to our high fixed costs, including aircraft lease commitments and debt service, a decrease in revenues results in a disproportionately greater decrease in earnings.

Our outstanding long-term debt and other fixed obligations could have important consequences. For example, they could:

- limit our ability to obtain additional financing to fund our future capital expenditures, acquisitions, working capital or other purposes;
- require us to dedicate a material portion of our operating cash flow to fund lease payments and interest payments on indebtedness, thereby reducing funds available for other purposes; and
- limit our ability to withstand competitive pressures and reduce our flexibility in responding to changing business and economic conditions, including reacting to the current economic slowdown.

Table of Contents

Although we have historically been able to generate sufficient cash flow from our operations to pay our debt and other fixed obligations as they become due, we cannot ensure we will be able to do so in the future. If we fail to do so, our business could be harmed.

Alaska is required to comply with specific financial covenants in certain agreements. We cannot be certain that Alaska will be able to comply with these covenants or provisions or that these requirements will not limit our ability to finance our future operations or capital needs.

See "Liquidity and Capital Resources" on page 44 for more detailed information about our obligations and commitments.

Our continuing obligation to fund our traditional defined-benefit pension plans could negatively affect our ability to compete in the marketplace.

Our defined-benefit pension plan assets are subject to market risk. If market returns are poor in the future, as they were in 2008, any future obligation to make additional cash contributions in accordance with the Pension Protection Act of 2006 could increase and harm our liquidity. Poor market returns also lead to higher pension expense in our statement of operations. The calculation of pension expense is dependent on many assumptions that are more fully described in "Critical Accounting Estimates" on page 42 and Note 8 to our consolidated financial statements.

Increases in insurance costs or reductions in insurance coverage would harm our business, financial condition and results of operations.

Aviation insurers could increase their premiums in the event of additional terrorist attacks, hijackings, airline accidents or other events adversely affecting the airline industry. Furthermore, the full hull and liability war risk insurance provided by the government is currently mandated through August 31, 2010. Although the government may again extend the deadline for providing such coverage, we cannot be certain that any extension will occur, or if it does, for how long the extension will last. It is expected that, should the government stop providing such coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government and the coverage will be much more limited, including smaller aggregate limits and shorter cancellation periods. Significant increases in insurance premiums would adversely affect our business, financial condition and results of operations.

SAFETY, COMPLIANCE AND OPERATIONAL EXCELLENCE

Our reputation and financial results could be harmed in the event of an airline accident or incident.

An accident or incident involving one of our aircraft could involve a significant loss of life and result in a loss of confidence in our airlines by the flying public. We could experience significant potential claims from injured passengers and surviving relatives, as well as costs for the repair or replacement of a damaged aircraft and its consequential temporary or permanent loss from service. We maintain liability insurance in amounts and of the type generally consistent with industry practice. However, the amount of such coverage may not be adequate to fully cover all claims and we may be forced to bear substantial losses from an accident. Substantial claims resulting from an accident in excess of our related insurance coverage would harm our business and financial results. Moreover, any aircraft accident or incident, even if fully insured and even if it does not involve one of our airlines, could cause a public perception that our airlines or the equipment they fly is less safe or reliable than other transportation alternatives, which would harm our business.

Changes in government regulation imposing additional requirements and restrictions on our operations or on the airports at which we operate could increase our operating costs and result in service delays and disruptions.

Airlines are subject to extensive regulatory and legal requirements, both domestically and internationally, that involve significant compliance costs. In the last several years, Congress has passed laws, and the U.S. DOT, the TSA and the FAA have issued regulations that have required significant expenditures relating to the maintenance and operation of airlines. Similarly, many aspects of an airline's operations are subject to increasingly stringent federal, state and local laws protecting the environment.

Because of significantly higher security and other costs incurred by airports since September 11, 2001, many airports have increased their rates and charges to air carriers. Additional laws, regulations, taxes, and airport rates and charges have been proposed from time to time that could significantly increase the cost of airline operations or reduce the demand for air travel. Although lawmakers may impose these additional fees and view them as "pass-through" costs, we believe that a higher total ticket price will influence consumer purchase and travel decisions and may result in an overall decline in passenger traffic, which would harm our business.

Table of Contents

If we do not maintain the privacy and security of customer-related information, we could damage our reputation, incur substantial additional costs and become subject to litigation.

We receive, retain, and transmit certain personal information about our customers. In addition, our online operations at alaskaair.com depend on the secure transmission of confidential information over public networks, including credit card information. A compromise of our security systems or those of other business partners that results in our customers' personal information being obtained by unauthorized persons could adversely affect our reputation with our customers and others, as well as our operations, results of operations, financial position and liquidity, and could result in litigation against us or the imposition of penalties. In addition, a security breach could require that we expend significant additional resources related to the security of information systems and could result in a disruption of our operations, particularly our online sales operations.

Additionally, the use of individually identifiable data by our business and our business partners is regulated at the international, federal and state levels. Privacy and information security laws and regulations change, and compliance with them may result in cost increases due to necessary systems changes and the development of new administrative processes.

The airline industry continues to face potential security concerns and related costs.

The terrorist attacks of September 11, 2001 and their aftermath negatively affected the airline industry, including our company. Additional terrorist attacks, the fear of such attacks or other hostilities involving the U.S. could have a further significant negative effect on the airline industry, including us, and could:

- significantly reduce passenger traffic and yields as a result of a potentially dramatic drop in demand for air travel;
- significantly increase security and insurance costs;
- make war risk or other insurance unavailable or extremely expensive;
- increase fuel costs and the volatility of fuel prices;
- increase costs from airport shutdowns, flight cancellations and delays resulting from security breaches and perceived safety threats; and
- result in a grounding of commercial air traffic by the FAA.

The occurrence of any of these events would harm our business, financial condition and results of operations.

Our operations are often affected by factors beyond our control, including delays, cancellations, and other conditions, which could harm our financial condition and results of operations.

Like other airlines, our operations often are affected by delays, cancellations and other conditions caused by factors largely beyond our control.

A local dam in the Kent Valley near the Seattle-Tacoma International Airport is partly compromised. Many of the services necessary for the operation of our airlines are located in the valley, e.g., fuel supply, power, catering, reservations call centers, etc. If the area experiences heavy rains, flooding could occur and our operations could be disrupted. The Army Corps of Engineers estimates that the dam will be repaired within three to five years. We have contingency plans in place and are continuing to monitor the situation.

Other conditions that might impact our operations include:

- air traffic congestion at airports or other air traffic control problems;
- adverse weather conditions;
- increased security measures or breaches in security;
- international or domestic conflicts or terrorist activity; and
- other changes in business conditions.

Due to our geographic area of operations, we believe a large portion of our operation is more susceptible to adverse weather conditions than that of many of our competitors. A general reduction in airline passenger traffic as a result of any of the above-mentioned factors could harm our business, financial condition and results of operations.

STRATEGY

We depend on a few key markets to be successful.

Our strategy is to focus on serving a few key markets, including Seattle, Portland, Los Angeles and Anchorage. A significant portion of our flights occurs to and from our Seattle hub. In 2009, passengers to and from Seattle accounted for 64% of our total passengers.

We believe that concentrating our service offerings in this way allows us to maximize our investment in personnel, aircraft, and ground facilities, as well as to gain greater advantage from sales and marketing efforts in those regions. As a result, we remain highly dependent on our key markets. Our business could be harmed by any circumstances causing a reduction in demand for air transportation in our key markets. An increase in competition in our key markets could also cause us to reduce fares or take other competitive measures that could harm our business, financial condition and results of operations.

Table of Contents

Our failure to successfully meet cost reduction goals at both Alaska and Horizon could harm our business.

We continue to strive toward aggressive cost-reduction goals that are an important part of our business strategy of offering the best value to passengers through competitive fares while achieving acceptable profit margins and return on capital. However, with our capacity reductions in 2009 and increased costs in areas such as wages and benefits, we experienced a 10% increase in non-fuel unit cost at Alaska and a 6% increase at Horizon. If we are unable to reduce our non-fuel unit costs over the long-term and achieve targeted profitability, we will likely not be able to grow our business in the future and therefore our financial results may suffer.

We rely on third-party vendors for certain critical activities.

We have historically relied on outside vendors for a variety of services and functions critical to our business, including airframe and engine maintenance, ground handling, fueling, computer reservation system hosting and software maintenance. As part of our cost-reduction efforts, our reliance on outside vendors has increased and may continue to do so in the future. In recent years, Alaska has subcontracted its heavy aircraft maintenance, fleet service, facilities maintenance, and ground handling services at certain airports, including Seattle-Tacoma International Airport, to outside vendors.

Our use of outside vendors increases our exposure to several risks. In the event that one or more vendors goes into bankruptcy, ceases operation or fails to perform as promised, replacement services may not be readily available at competitive rates, or at all. Although we believe that our vendor oversight and quality control is among the best in the industry, if one of our vendors fails to perform adequately we may experience increased costs, delays, maintenance issues, safety issues or negative public perception of our airline. Vendor bankruptcies, unionization, regulatory compliance issues or significant changes in the competitive marketplace among suppliers could adversely affect vendor services or force Alaska to renegotiate existing agreements on less favorable terms. These events could result in disruptions in Alaska’s operations or increases in its cost structure.

We are dependent on a limited number of suppliers for aircraft and parts.

Alaska is dependent on Boeing as its sole supplier for aircraft and many of its aircraft parts. Horizon is similarly dependent on Bombardier. Additionally, each carrier is dependent on sole suppliers for aircraft engines. As a result, we are more vulnerable to any problems associated with the supply of those aircraft and parts, including design defects, mechanical problems, contractual performance by the manufacturers, or adverse perception by the public that would result in customer avoidance or in actions by the FAA resulting in an inability to operate our aircraft.

INFORMATION TECHNOLOGY

We rely heavily on automated systems to operate our business, and a failure of these systems or by their operators could harm our business.

We depend on automated systems to operate our business, including our airline reservation system, our telecommunication systems, our website, our maintenance systems, our kiosk check-in terminals, and other systems. Substantially all of our tickets are issued to passengers as electronic tickets and the majority of our customers check in using our website or our airport kiosks. We depend on our reservation system to be able to issue, track and accept these electronic tickets. In order for our operations to work efficiently, our website, reservation system, and check-in systems must be able to accommodate a high volume of traffic, maintain secure information, and deliver important flight information. Substantial or repeated website, reservations system or telecommunication systems failures could reduce the attractiveness of our services and cause our customers to purchase tickets from another airline. In addition, we rely on other automated systems for crew scheduling, flight dispatch, and other operational needs. Disruption in, changes to, or a breach of these systems could result in the loss of important data, an increase of our expenses and a possible temporary cessation of our operations.

BRAND AND REPUTATION

A significant increase in labor costs or change in key personnel could adversely affect our business and results of operations.

We compete against the major U.S. airlines and other businesses for labor in many highly skilled positions. If we are unable to hire, train and retain qualified employees at a reasonable cost, or if we lose the services of key personnel, we may be unable to grow or sustain our business. In such case, our operating results and business prospects could be harmed. We may also have difficulty replacing management or other key personnel who leave and, therefore, the loss of any of these individuals could harm our business.

Labor costs are a significant component of our total expenses, accounting for approximately 34% and 25% of our total operating expenses in 2009 and 2008, respectively. As of December 31, 2009, labor unions represented approximately 82% of Alaska’s and 46% of Horizon’s employees. Each of our represented employee groups has a separate collective bargaining agreement, and could make demands that would increase our operating expenses and adversely affect our financial performance if we agree to them. Although we have been successful in negotiating new contracts or extending existing contracts with a number of workgroups recently, future uncertainty around open contracts could be a distraction to many employees, reduce employee engagement in our business and divert management’s attention from other projects and issues.

Table of Contents

Horizon is currently in negotiations with the IBT on a new pilot agreement and has been since the contract first became amendable in September 2006. In January 2010, Horizon and the IBT filed separate requests for assistance from the NMB in our ongoing negotiations. Factoring in pay rates and productivity measures, we believe our pilot unit costs at Horizon are among the highest in the industry for the size of aircraft we operate.

We rely on partner airlines for codeshare and frequent flyer marketing arrangements.

Alaska and Horizon are parties to marketing agreements with a number of domestic and international air carriers, or "partners," including, but not limited to, American Airlines and Delta Air Lines. These agreements provide that certain flight segments operated by us are held out as partner "codeshare" flights and that certain partner flights are held out for sale as Alaska codeshare flights. In addition, the agreements generally provide that members of Alaska's Mileage Plan program can earn miles on or redeem miles for partner flights and vice versa. We receive a significant amount of revenue from flights sold under codeshare arrangements. In addition, we believe that the frequent flyer arrangements are an important part of our Mileage Plan program. The loss of a significant partner or certain partner flights could have a negative effect on our revenues or the attractiveness of our Mileage Plan, which we believe is a source of competitive advantage.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

AIRCRAFT

The following tables describe the aircraft we operate and their average age at December 31, 2009:

Aircraft Type	Passenger Capacity	Owned	Leased	Total	Average Age in Years
Alaska Airlines					
Boeing:					
737-400	144	3	24	27	14.1
737-400C*	72	5	—	5	17.3
737-400F*	—	1	—	1	10.8
737-700	124	17	2	19	9.1
737-800	157	41	10	51	2.3
737-900	172	12	—	12	7.4
Total		79	36	115	7.5
Horizon Air					
Bombardier:					
Q400	76	25	15	40	5.1
CRJ-700	70	2	16	18	7.3
Total		27	31	58	5.8

*C=Combination freighter/passenger; F=Freighter

Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," discusses future orders and options for additional aircraft.

Most of our owned aircraft secure long-term debt arrangements or collateralize our revolving credit facility. See further discussion in "Liquidity and Capital Resouces" on page 44.

Alaska's leased 737-400, 737-700, and 737-800 aircraft have lease expiration dates between 2010 and 2016, in 2010, and between 2015 and 2021, respectively. Alaska has four MD-80 aircraft, one owned and three under long-term lease arrangements through 2012, currently in temporary storage. Horizon's leased Q400 and CRJ-700 aircraft have expiration dates in 2018 and between 2018 and 2020, respectively. Horizon also has 16 leased Q200 aircraft and two leased CRJ-700 aircraft that are subleased to third-party carriers. Alaska and Horizon have the option to extend most of the leases for additional periods, or the right to purchase the aircraft at the end of the lease term, usually at the then-fair-market value of the aircraft.

Alaska completed its transition to an all-Boeing operating fleet during 2008. Horizon's long-term goal is to transition to an all-Q400 operating fleet. As market conditions have hindered the remarketing efforts on the CRJ-700 aircraft and as Horizon has successfully deferred future Q400 deliveries, the fleet transition plan has been delayed until market conditions improve.

Table of Contents

The following table displays the currently anticipated fleet counts for Alaska and Horizon as of the end of each quarter in 2010. This plan assumes that we are able to remarket three CRJ-700 aircraft in the first half of 2010. Given current market conditions, there is no assurance that we will be successful in doing so.

	31-Mar-10	30-Jun-10	30-Sep-10	31-Dec-10
Alaska Airlines				
737-400	24	24	24	23
737-400C*	5	5	5	5
737-400F*	1	1	1	1
737-700	19	19	18	17
737-800	51	55	55	55
737-900	12	12	12	12
Totals	112	116	115	113
Horizon Air				
Q400	40	40	40	40
CRJ-700	18	15	15	15
Totals	58	55	55	55

*C=Combination freighter/passenger; F=Freighter

GROUND FACILITIES AND SERVICES

Alaska and Horizon lease ticket counters, gates, cargo and baggage space, office space, and other support areas at the majority of the airports they serve. Alaska also owns terminal buildings in various cities in the state of Alaska.

Alaska has centralized operations in several buildings located at or near Seattle-Tacoma International Airport (Sea-Tac) near Seattle, Wash. These include a five-bay hangar and shops complex (used primarily for line maintenance), a flight operations and training center, an air cargo facility, an information technology office and datacenter, an office building, and corporate headquarters complex. Alaska also leases a stores warehouse, and office space for a customer service and reservation facility in Kent, Wash. Alaska’s major facilities outside of Seattle include a regional headquarters building, an air cargo facility and a hangar/office facility in Anchorage, as well as leased reservations facilities in Phoenix, Ariz. and Boise, Idaho. Alaska uses its own employees for ground handling services at most of our airports in the state of Alaska. At other airports throughout our system, those services are contracted to various third-party vendors.

Horizon owns its Seattle corporate headquarters building. It leases an operations, training, and aircraft maintenance facility in Portland as well as line maintenance stations in Boise, Spokane, Pasco, Eugene, Los Angeles and Seattle.

ITEM 3. LEGAL PROCEEDINGS

Grievance with International Association of Machinists

In June 2005, the International Association of Machinists (IAM) filed a grievance under its Collective Bargaining Agreement (CBA) alleging that Alaska violated the CBA by, among other things, subcontracting the ramp service operation in Seattle. The dispute was referred to an arbitrator and hearings on the grievance commenced in January 2007, with a final hearing date in August 2007. In February 2010, the arbitrator issued a final decision. The decision does not require Alaska to alter the existing subcontracting arrangements for ramp service in Seattle. The award sustains the right to subcontract other operations in the future so long as the requirements of the CBA are met. The award imposes monetary remedies which have not been fully calculated, but are not expected to be material.

Other items

We are a party to routine litigation matters incidental to our business and with respect to which no material liability is expected.

Management believes the ultimate disposition of these matters is not likely to materially affect our financial position or results of operations. This forward-looking statement is based on management's current understanding of the relevant law and facts, and it is subject to various contingencies, including the potential costs and risks associated with litigation and the actions of judges and juries.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Table of Contents

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

As of December 31, 2009, there were 35,591,008 shares of common stock of Alaska Air Group, Inc. issued and outstanding and 3,406 shareholders of record. We also held 252,084 treasury shares at a cost of $5.7 million. We have not paid dividends on the common stock since 1992 and have no plans to do so in the foreseeable future. Our common stock is listed on the New York Stock Exchange (symbol: ALK).

The following table shows the trading range of Alaska Air Group, Inc. common stock on the New York Stock Exchange.

	2009		2008	
	High	Low	High	Low
First Quarter	$ 30.95	$ 13.61	$ 28.56	$ 17.44
Second Quarter	22.08	14.53	23.00	15.34
Third Quarter	27.99	17.93	24.68	10.10
Fourth Quarter	36.48	24.91	29.74	12.89

SALES OF NON-REGISTERED SECURITIES

None

PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

	Total Number of Shares Purchased	Average Price Paid per Share	Maximum remaining dollar value of shares that can be purchased under the plan
June 11, 2009 – June 30, 2009 (1)	700,000	$ 16.89	
July 1, 2009 – July 31, 2009 (1)	624,578	$ 19.12	
Total	1,324,578	$ 17.94	$ 26,234,104

(1) Purchased pursuant to a $50 million repurchase plan authorized by the Board of Directors in June 2009. The plan expires after twelve months. There were no purchases under this plan subsequent to July 2009 through the end of 2009. However, we have resumed purchases subsequent to December 31, 2009.

In October 2009, Air Group delisted 7,900,000 common shares that had been held in treasury stock on the consolidated balance sheet in prior periods. The action did not impact the total number of common shares outstanding.

Table of Contents

PERFORMANCE GRAPH

The following graph compares our cumulative total stockholder return since December 31, 2004 with the S&P 500 Index and the Dow Jones U.S. Airlines Index. The graph assumes that the value of the investment in our common stock and each index (including reinvestment of dividends) was $100 on December 31, 2004.

Table of Contents

ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

	2009	2008	2007	2006	2005
CONSOLIDATED OPERATING RESULTS (audited)					
Year Ended December 31 (in millions, except per share amounts):					
Operating Revenues	$ 3,399.8	$ 3,662.6	$ 3,506.0	$ 3,334.4	$ 2,975.3
Operating Expenses	3,132.4	3,834.8	3,295.1	3,424.6	2,808.8
Operating Income (Loss)	267.4	(172.2)	210.9	(90.2)	166.5
Nonoperating income (expense), net of interest capitalized (a)	(64.5)	(41.0)	(10.4)	(0.5)	(29.3)
Income (loss) before income tax and accounting change	202.9	(213.2)	200.5	(90.7)	137.2
Income (loss) before accounting change	202.9	(135.9)	124.3	(54.5)	84.5
Net Income (Loss)	$ 121.6	$ (135.9)	$ 124.3	$ (54.5)	$ (5.9)
Average basic shares outstanding	35.815	36.343	40.125	37.939	27.609
Average diluted shares outstanding	36.154	36.343	40.424	37.939	33.917
Basic earnings (loss) per share before accounting change	$ 3.39	$ (3.74)	$ 3.10	$ (1.44)	$ 3.06
Basic earnings (loss) per share	3.39	(3.74)	3.10	(1.44)	(0.21)
Diluted earnings (loss) per share before accounting change	3.36	(3.74)	3.07	(1.44)	2.65
Diluted earnings (loss) per share	3.36	(3.74)	3.07	(1.44)	(0.01)
CONSOLIDATED FINANCIAL POSITION (audited)					
At End of Period (in millions, except ratio):					
Total assets	$ 4,985.0	$ 4,835.6	$ 4,490.9	$ 4,077.1	$ 3,792.0
Long-term debt and capital lease obligations, net of current portion	1,699.2	1,596.3	1,124.6	1,031.7	969.1
Shareholders' equity	872.1	661.9	1,025.4	886.5	827.6
Ratio of earnings to fixed charges (b) (unaudited)	1.92	(0.10)	1.83	0.40	1.72
STATISTICS (unaudited)					
Alaska Airlines Mainline Operating Data:					

Revenue passengers (000)	15,561		16,809		17,558		17,165		16,759	
Revenue passenger miles (RPM) (000,000)	18,362		18,712		18,451		17,822		16,915	
Available seat miles (ASM) (000,000)	23,144		24,218		24,208		23,278		22,292	
Revenue passenger load factor	79.3	%	77.3	%	76.2	%	76.6	%	75.9	%
Yield per passenger mile	13.28	¢	14.13	¢	13.81	¢	13.76	¢	12.91	¢
Operating revenues per ASM	11.74	¢	12.06	¢	11.52	¢	11.50	¢	10.76	¢
Operating expenses per ASM	10.78	¢	12.54	¢	10.55	¢	11.93	¢	10.14	¢
Operating expenses per ASM, excluding fuel and noted items (d)	8.26	¢	7.49	¢	7.50	¢	7.76	¢	7.90	¢
Average number of full-time equivalent employees	8,915		9,628		9,679		9,322		9,065	
Operating fleet at period-end	115		110		115		114		110	
Horizon Air Combined Operating Data (c):										
Revenue passengers (000)	6,759		7,390		7,552		6,860		6,481	
Revenue passenger miles (RPM) (000,000)	2,408		2,635		2,918		2,691		2,475	
Available seat miles (ASM) (000,000)	3,292		3,617		3,978		3,632		3,400	
Revenue passenger load factor	73.1	%	72.9	%	73.4	%	74.1	%	72.8	%
Yield per passenger mile	26.73	¢	27.43	¢	24.30	¢	23.53	¢	21.98	¢
Operating revenues per ASM	19.88	¢	20.29	¢	18.06	¢	17.73	¢	16.36	¢
Operating expenses per ASM	18.64	¢	21.42	¢	18.07	¢	17.41	¢	15.50	¢
Operating expenses per ASM, excluding fuel and noted items (d)	15.33	¢	14.52	¢	14.58	¢	14.20	¢	13.36	¢
Average number of full-time equivalent employees	3,308		3,699		3,897		3,611		3,456	
Operating fleet at period-end	58		59		70		69		65	

(a) Includes capitalized interest of $7.6 million, $23.2 million, $27.8 million, $24.7 million, $8.9 million, $1.7 million, $2.3 million, $2.7 million, $10.6 million, $17.7 million, and $12.6 million for 2009, 2008, 2007, 2006, 2005, 2004, 2003, 2002, 2001, 2000, and 1999, respectively.

(b) For 2008, 2006, 2004, 2002, 2001, and 2000 earnings are inadequate to cover fixed charges by $236.4 million, $115.4 million, $17.4 million, $99.5 million, $69.1 million, and $44.6 million, respectively. See Exhibit 12.1 to this Form 10-K.

- 20 -

Table of Contents

ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA - (continued)

	2004	2003	2002	2001	2000	1999
CONSOLIDATED OPERATING RESULTS (audited)						
Year Ended December 31 (in millions, except per share amounts):						
Operating Revenues	$ 2,723.8	$ 2,444.8	$ 2,224.1	$ 2,152.8	$ 2,194.0	$ 2,091.5
Operating Expenses	2,718.1	2,455.9	2,317.3	2,279.1	2,227.1	1,901.7
Operating Income (Loss)	5.7	(17.511.1)	(93.2)	(126.3)	(33.1)	189.8
Nonoperating income (expense), net of interest capitalized (a)	(26.3)	46.540.1	(8.6)	62.8	6.2	23.2
Income (loss) before income tax and accounting change	(20.6)	29.0	(101.8)	(63.5)	(26.9)	213.0
Income (loss) before accounting change	(15.3)	13.5	(67.2)	(43.4)	(20.4)	129.4
Net Income (Loss)	$ (15.3)	$ 13.5	$ (118.6)	$ (43.4)	$ (67.2)	$ 129.4
Average basic shares outstanding						
Average diluted shares outstanding	26.859	26.648	26.546	26.499	26.440	26.372
Basic earnings (loss) per share before accounting change	26.859	26.730	26.546	26.499	26.440	26.507
Basic earnings (loss) per share	$ (0.57)	$ 0.51	$ (2.53)	$ (1.64)	$ (0.77)	$ 4.91
Diluted earnings (loss) per share before accounting change	(0.57)	0.51	(4.47)	(1.64)	(2.54)	4.91
Diluted earnings (loss) per share	(0.57)	0.51	(2.53)	(1.64)	(0.77)	4.88
CONSOLIDATED FINANCIAL POSITION (audited)	(0.57)	0.51	(4.47)	(1.64)	(2.54)	4.88
At End of Period (in millions, except ratio):						
Total assets	$ 3,335.0	$ 3,259.2	$ 2,880.7	$ 2,950.5	$ 2,528.1	$ 2,196.0
Long-term debt and capital lease obligations, net of current portion	989.6	906.9	856.7	852.2	509.2	337.0
Shareholders' equity	664.8	674.2	655.7	851.3	895.1	959.2
Ratio of earnings to fixed charges (b) (unaudited)	0.89	1.22	0.28	0.48	0.66	3.07
STATISTICS (unaudited)						

Alaska Airlines Mainline Operating Data:						
Revenue passengers (000)	16,295	15,047	14,154	13,668	13,525	13,620
Revenue passenger miles (RPM) (000,000)	16,231	14,554	13,186	12,249	11,986	11,777
Available seat miles (ASM) (000,000)	22,276	20,804	19,360	17,919	17,315	17,341
Revenue passenger load factor	72.9 %	70.0 %	68.1 %	68.4 %	69.2 %	67.9 %
Yield per passenger mile	12.47 ¢	12.65 ¢	12.65 ¢	13.12 ¢	13.56 ¢	12.86 ¢
Operating revenues per ASM	10.02 ¢	9.74 ¢	9.47 ¢	9.84 ¢	10.20 ¢	9.75 ¢
Operating expenses per ASM	10.07 ¢	9.81 ¢	9.87 ¢	10.24 ¢	10.35 ¢	9.81 ¢
Operating expenses per ASM, excluding fuel and noted items (d)	7.92 ¢	8.34 ¢	8.52 ¢	8.73 ¢	8.54 ¢	8.63 ¢
Average number of full-time equivalent employees	9,968	10,040	10,142	10,115	9,611	9,183
Operating fleet at period-end	108	109	102	101	95	89
Horizon Air Combined Operating Data (c):						
Revenue passengers (000)	5,930	4,934	4,815	4,668	5,044	4,984
Revenue passenger miles (RPM) (000,000)	2,155	1,640	1,514	1,350	1,428	1,379
Available seat miles (ASM) (000,000)	3,107	2,569	2,428	2,148	2,299	2,194
Revenue passenger load factor	69.3 %	63.9 %	62.4 %	62.8 %	62.1 %	62.9 %
Yield per passenger mile	22.61 ¢	26.96 ¢	26.02 ¢	28.15 ¢	29.82 ¢	28.77 ¢
Operating revenues per ASM	16.20 ¢	18.06 ¢	17.29 ¢	19.02 ¢	19.27 ¢	18.96 ¢
Operating expenses per ASM	15.57 ¢	17.79 ¢	17.87 ¢	21.02 ¢	19.53 ¢	17.74 ¢
Operating expenses per ASM, excluding fuel and noted items (d)	13.58 ¢	15.80 ¢	15.99 ¢	18.48 ¢	16.48 ¢	15.79 ¢
Average number of full-time equivalent employees	3,423	3,361	3,476	3,764	3,795	3,603
Operating fleet at period-end	65	62	63	60	62	62

(c) Includes Horizon services operated as Frontier JetExpress in 2004 through 2007 and flights operated under the Capacity Purchase Agreement with Alaska in 2007 through 2009.

(d) See reconciliation of this measure to the most directly related GAAP measure in the "Results of Operations" section for both Alaska and Horizon.

- 21 -

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to help the reader understand the Company, our operations and our present business environment. MD&A is provided as a supplement to – and should be read in conjunction with – our consolidated financial statements and the accompanying notes. All statements in the following discussion that are not statements of historical information or descriptions of current accounting policy are forward-looking statements. Please consider our forward-looking statements in light of the risks referred to in this report's introductory cautionary note and the risks mentioned in Part I, "Item 1A. Risk Factors." This overview summarizes the MD&A, which includes the following sections:

- Year in Review—highlights from 2009 outlining some of the major events that happened during the year and how they affected our financial performance.

- Results of Operations—an in-depth analysis of the results of operations of Alaska and Horizon for the three years presented in our consolidated financial statements. We believe this analysis will help the reader better understand our consolidated statements of operations. Financial and statistical data for Alaska and Horizon are also included here. This section includes forward-looking statements regarding our view of 2010.

- Critical Accounting Estimates—a discussion of our accounting estimates that involve significant judgment and uncertainties.

- Liquidity and Capital Resources—an analysis of cash flows, sources and uses of cash, contractual obligations, commitments and off-balance sheet arrangements, an overview of financial position and the impact of inflation and changing prices.

YEAR IN REVIEW

Our 2009 consolidated pretax income was $202.9 million compared to a pretax loss of $213.2 million in 2008. The $416.1 million improvement in our pretax earnings was primarily due to the $702.4 million decline in aircraft fuel costs and other non-fuel operating costs, partially offset by a $262.8 million decline in operating revenues. The decline in fuel cost was substantially driven by the 43% reduction in the raw cost of fuel per gallon. The 7.2% decline in operating revenues can be attributed to the following:

- a 7.9% decline in passenger revenue because of demand weakness stemming from the economic recession; and

- a one-time benefit of $42.3 million recorded in 2008 associated with a change in our Mileage Plan terms.

These declines were offset by:

- our new $15 first bag service charge, which went into effect on July 7, 2009. In 2009, the fee generated $47.4 million of incremental revenue.

- a $39.7 million improvement in Mileage Plan commission revenues included in "Other-net."

See "Results of Operations" below for further discussion of changes in revenues and operating expenses for both Alaska and Horizon.

Accomplishments and Highlights

Accomplishments and highlights from 2009 include:

- Alaska and Horizon both improved their operational performance again in 2009 as measured by on-time arrivals and completion rate as reported to the Department of Transportation (DOT). At Alaska, we led the ten largest carriers in on-time performance for eight months of the year. If Horizon were a DOT reporting entity, they would have led reporting mainland US carriers for the year with their 86.1% on-time performance in 2009.

- For the second year in a row, Alaska Airlines ranked “Highest in Customer Satisfaction among Traditional Network Carriers” in 2009 by J.D. Power and Associates.

- Alaska won the 2008 “Program of the Year” Freddie award for our Mileage Plan program in 2009. This is the fifth time that we have won this highest award and the second year in a row. We also won top honors for “Best Web Site,” “Best Elite-Level Program,” and “Best Member Communications.”

- During the year, we reached agreements with several of our labor groups that provide for improved productivity and a common gain-sharing formula. See “Update on Labor Negotiations” below for further discussion.

Table of Contents

- For the year, our employees earned $76 million in incentive pay for meeting certain operational and financial goals. We also contributed nearly $150 million to Alaska's defined benefit pension plans.

Update on Labor Negotiations

Both Alaska and Horizon have had success recently with new bargaining agreements or contract extensions with a number of represented employees. All of the new agreements or extensions ratified in 2009 include participation by the represented employees in Air Group's Performance-Based Pay (PBP) incentive plan as approved by the Compensation Committee of the Board of Directors. PBP is described in Note 8 to the consolidated financial statements. Our ultimate goal is to include all Air Group employees in PBP in order to have common goals and targets that everyone is working together to achieve.

New Alaska Pilot Contract
On May 19, 2009, Alaska's pilots, represented by the Air Line Pilots Association, ratified a new four-year contract. This negotiated agreement replaces the contract that had been in place since May 1, 2005. The terms of the 2005 contract were the result of an arbitrator's decision and included immediate wage reductions that averaged approximately 26% across the pilot group, work rule changes, and higher employee health care contributions.

The significant terms of the new contract are as follows:

- Average pilot wages increased approximately 14% effective April 1, 2009. The contract also provides for step increases of 1.5% on the first two anniversary dates of the contract and 1.8% on the third anniversary.

- Participation in PBP.

- The defined-benefit pension plan for pilots is now closed to new entrants. Newly hired pilots will participate in a defined-contribution plan that includes a contribution by Alaska equal to 13.5% of eligible wages. Incumbents had the option of (1) remaining in the defined-benefit pension plan, (2) moving to a new blended option with lower service credit under the defined benefit plan and higher 401(k) contribution or (3) voluntarily freezing service credit in the existing defined benefit plan in exchange for a higher 401(k) contribution.

- Upon retirement, pilots are now allowed to receive a cash payment of an amount equivalent to 25% of their accrued sick leave balance multiplied by their hourly rate.

- The new contract provides for better productivity and flexibility. We expect to realize savings from these productivity enhancements when we resume capacity growth.

Pilots received a one-time bonus of $20.3 million in the aggregate following ratification of the contract. The transition expense associated with establishing the sick-leave payout program described above was $15.5 million. These items have been combined and reported in 2009 as "New pilot contract transition costs" in the consolidated statements of operations.

Contract Extensions at Alaska
In March 2009, Alaska's flight attendants, represented by the AFA, ratified a two-year contract extension. The contract will become amendable in April 2012. As part of the contract, flight attendants will receive a 1.5% pay increase on May 1, 2010 and May 1, 2011 and will participate in PBP. The flight attendants received a bonus upon ratification of the contract totaling $2.0 million in the aggregate.

In August 2009, Alaska and its aircraft technicians reached an agreement on a two-year contract extension. The extended contract, which becomes amendable on October 17, 2011, provides technicians with 1.5% pay scale increases in October 2009 and 2010. Technicians now also participate in PBP. The technicians received a bonus upon ratification of the contract totaling $1.3 million in the aggregate.

In December 2009, Alaska's ramp service and stores agents, represented by the IAM, ratified a two-year extension of their collective bargaining agreement, which will now become amendable on July 19, 2012. This agreement includes participation in PBP, a 1.5% pay increase in June 2010 and 2011, and a signing bonus of approximately $0.5 million in the aggregate.

Alaska's clerical, office and passenger service employees (COPS), also represented by the IAM, rejected a two-year extension proposal nearly identical to the terms of the proposal ratified by the ramp service employees and stores agents. As a result, COPS employees are the only remaining work group at Alaska, besides station personnel in Mexico, that participate in a profit-sharing plan other than PBP.

Horizon Labor Contracts

Horizon's dispatchers, represented by the TWU, ratified a new contract in July 2009, expiring in October 2010. This contract includes a transition from the former profit-sharing plan to PBP.

In December 2009, Horizon's flight attendants, represented by the AFA, ratified a new two-year contract. The agreement includes participation in PBP in 2009 and beyond, at least a 3% pay increase over the life of the contract, and a signing bonus of $0.3 million in the aggregate.

Historically, only a small percentage of non-represented employees at Horizon participated in the PBP plan. To better align the incentive plans for this group with other Horizon and Alaska employees, Horizon has also added all remaining non-represented employees (approximately 1,400 people) to the PBP plan in 2009.

Table of Contents

Horizon is currently in negotiations with its pilots and aircraft technicians. Horizon and the IBT recently filed separate requests for assistance for the NMB in the ongoing pilot contract negotiations. Horizon's aircraft technicians voted in 2009 to be represented by the IBT. They were previously represented by the Aircraft Mechanics Fraternal Association. Horizon's pilots and mechanics remain in a profit-sharing plan program other than PBP.

Horizon Fleet Transition

Horizon's long-term goal is to transition to an all-Q400 fleet. In the first quarter of 2009, Horizon removed the final six Q200 aircraft from operations. These aircraft were disposed of in the last six months of 2009 and the related lease agreements were terminated. We recorded charges of $8.8 million in 2009 associated with removing these aircraft from operation.

Although we have been actively pursuing various alternatives to dispose of our 18 CRJ-700 aircraft in the most economically feasible way, the current economic conditions have hindered the remarketing efforts. As a result, the transition to an all-Q400 fleet will be delayed and we will continue to operate the CRJ-700 aircraft in our operating fleet. We have successfully deferred 2010 and 2011 Q400 deliveries into future years to better manage our fleet size and capacity plans.

New Mileage Plan Affinity Card Agreement

In June 2009, we revised our Mileage Plan affinity credit card agreement with Bank of America. This revised agreement enhances the economics of our Mileage Plan program and provides for, among other things, an increase in the rate at which we sell miles to the bank. This revised agreement was effective January 1, 2009 and expires on December 31, 2014.

First Bag Service Charge

In 2009, we joined nearly all major domestic carriers in charging for a first checked bag. The $15 service charge began July 7, 2009. This fee does not apply to our MVP or MVP Gold Mileage Plan members, for those traveling solely with the state of Alaska, or for certain other passengers. This service charge generated $47.4 million of incremental revenue in the last six months of 2009.

New Baggage Service Guarantee

Concurrent with the first bag service charge, we introduced a guarantee to compensate passengers if their bags are not at the baggage claim within 25 minutes after their flight parks at the gate. Passengers have the choice of 2,500 Mileage Plan miles or a $25 voucher that can be used on a future flight. This guarantee is for all passengers with luggage, including those not subject to the bag service charge. We believe that we are the only airline that offers this guarantee to customers. To date, the cost of providing this guarantee has been minimal as our baggage performance has been excellent.

New Markets

In 2009, Alaska added several new cities and non-stop routes to our overall network. Those new routes are:

New Non-Stop Routes	Frequency	Start Date
Between Bellingham, Wash. and Las Vegas	4 x weekly	6/25/2009
	Daily	7/3/2009

Between Portland, Ore. and Maui		
Between Seattle and Austin, Tex.	Daily	8/3/2009
Between San Jose and Austin	Daily	9/2/2009
Between Seattle and Houston	Daily	9/23/2009
Between Seattle and Atlanta	Daily	10/23/2009
Between Oakland, Calif. and Maui	4 x weekly	11/9/2009
Between Oakland and Kona	3 x weekly	11/10/2009
Service between Portland and Chicago	Daily	11/16/2009

Horizon also announced expanded seasonal service to Mammoth Lakes, Calif. from San Jose, Reno, Seattle and Portland. The flights will operate from December 17, 2009 to April 11, 2010.

Stock Repurchase

In June 2009, our Board of Directors authorized the Company to repurchase up to $50 million of our common stock, at which time the stock price was $15.60. Through December 31, 2009, we had repurchased 1,324,578 shares of common stock for approximately $23.8 million under this program. This program expires in June 2010.

Outlook

Our primary focus every year is to run safe, compliant and reliable operations at our airlines. In addition to our primary objective, in 2010 our key initiative is to maintain our focus on optimizing revenue. Our specific focus will be on the way we merchandise fares and ancillary products and services, as well as broader employee involvement in our marketing efforts. In addition to the focus on revenue, both of our airlines have initiatives under way designed to reduce costs. Alaska is focused on improving productivity and controlling overhead. Horizon aims to reduce maintenance costs and pilot labor costs.

Our fourth quarter 2009 revenue performance marked the first quarter-over-quarter improvement in the top line in 2009, providing a solid outlook as we move into 2010.

For the first quarter, our advance booked load factors are up significantly at both Alaska and Horizon, although we expect the higher load factors, which were driven by deep price discounting, will be offset by a decline in yields, resulting in only modest unit revenue increases in the first quarter.

Table of Contents

RESULTS OF OPERATIONS

2009 COMPARED WITH 2008

Our consolidated net income for 2009 was $121.6 million, or $3.36 per diluted share, compared to a net loss of $135.9 million, or $3.74 per share, in 2008. Items that impact the comparability between the periods are as follows:

- Both periods include adjustments to reflect timing of gain and loss recognition resulting from mark-to-market fuel hedge accounting. For 2009, we recognized net mark-to-market gains of $88.8 million ($55.2 million after tax, or $1.53 per share), compared to net losses of $142.3 million ($89.2 million after tax, or $2.46 per share) in 2008.
- 2009 included the new pilot contract transition costs of $35.8 million ($22.3 million after tax, or $0.62 per share).
- 2008 included fleet transition costs of $61.0 million ($38.2 million after tax, or $1.05 per share) related to the ongoing transitions out of the MD-80 and CRJ-700 fleets.
- 2008 included realized losses on the early termination of fuel-hedge contracts originally scheduled to settle in 2009 and 2010 of $50 million ($31.3 million after tax, or $0.86 per share).
- 2008 included a $42.3 million benefit ($26.5 million after tax, or $0.73 per share) related to a change in the terms of our Mileage Plan program.
- 2008 included restructuring charges of $12.9 million ($8.1 million after tax, or $0.22 per share) related to the reduction in work force at Alaska.

ADJUSTED (NON-GAAP) RESULTS AND PER-SHARE AMOUNTS

We believe disclosure of earnings excluding the impact of these individual charges is useful information to investors because:

- It is consistent with how we present information in our quarterly earnings press releases;
- We believe it is the basis by which we are evaluated by industry analysts;
- Our results excluding these items are most often used in internal management and board reporting and decision-making;
- Our results excluding these adjustments serve as the basis for our various employee incentive plans, thus the information allows investors to better understand the changes in variable incentive pay expense in our consolidated statements of operations; and
- It is useful to monitor performance without these items as it improves a reader's ability to compare our results to those of other airlines.

Although we are presenting these non-GAAP amounts for the reasons above, investors and other readers should not necessarily conclude that these amounts are non-recurring, infrequent, or unusual in nature.

Excluding the items noted above, and as shown in the following table, our consolidated net income for 2009 was $88.7 million, or $2.45 per diluted share, compared to $4.4 million, or $0.12 per diluted share, in 2008.

	Years Ended December 31			
	2009		2008	
(in millions except per share amounts)	Dollars	Diluted EPS	Dollars	Diluted EPS
Net income and diluted EPS, excluding noted items	$ 88.7	$ 2.45	$ 4.4	$ 0.12
Change in Mileage Plan terms, net of tax	--	--	26.5	0.73
New pilot contract transition costs, net of tax	(22.3)	(0.62)	--	--
Restructuring charges, net of tax	--	--	(8.1)	(0.22)
Fleet transition costs – MD-80, net of tax	--	--	(29.8)	(0.82)
Fleet transition costs – CRJ-700, net of tax	--	--	(8.4)	(0.23)
Mark-to-market fuel hedge adjustments, net of tax	55.2	1.53	(89.2)	(2.46)
Realized losses on hedge portfolio restructuring, net of tax	--	--	(31.3)	(0.86)
Net income and diluted EPS as reported	$ 121.6	$ 3.36	$ (135.9)	$ (3.74)

INDIVIDUAL SUBSIDIARY RESULTS

Our consolidated results are primarily driven by the results of our two operating carriers. Alaska and Horizon reported pretax income of $183.8 million and $22.8 million, respectively, in 2009. Financial and statistical data and an in-depth discussion of the results of Alaska and Horizon are on the following pages. For a reconciliation of these subsidiary results to the consolidated results of Air Group, see Note 13 in the consolidated financial statements.

ALASKA AIRLINES FINANCIAL AND STATISTICAL DATA

Financial Data (in millions):	Three Months Ended December 31 2009	2008	% Change	Year Ended December 31 2009	2008	% Change	2007	% Change
Operating Revenues:								
Passenger	$ 594.5	$ 602.5	(1.3)	$ 2,438.8	$ 2,643.7	(7.8)	$ 2,547.2	3.8
Freight and mail	22.5	22.2	1.4	91.5	99.3	(7.9)	94.2	5.4
Other - net	50.8	34.0	49.4	187.3	135.2	38.5	147.1	(8.1)
Change in Mileage Plan terms	-	-	NM	-	42.3	NM	-	NM
Total mainline operating revenues	667.8	658.7	1.4	2,717.6	2,920.5	(6.9)	2,788.5	4.7
Passenger - purchased capacity	77.0	66.9	15.1	288.4	300.8	(4.1)	281.4	6.9
Total Operating Revenues	744.8	725.6	2.6	3,006.0	3,221.3	(6.7)	3,069.9	4.9
Operating Expenses:								
Wages and benefits	197.7	183.8	7.6	792.6	742.7	6.7	753.9	(1.5)
Variable incentive pay	17.6	5.0	252.0	61.6	15.8	289.9	13.5	17.0
Aircraft fuel, including hedging gains and losses	143.1	298.4	(52.0)	549.0	1,162.4	(52.8)	737.5	57.6
Aircraft maintenance	40.5	38.5	5.2	169.9	150.6	12.8	149.8	0.5
Aircraft rent	27.2	23.8	14.3	109.0	106.2	2.6	112.8	(5.9)
Landing fees and other rentals	42.4	40.8	3.9	166.8	167.7	(0.5)	170.1	(1.4)
Contracted services	30.3	29.7	2.0	118.9	130.2	(8.7)	124.1	4.9
Selling expenses	27.9	20.4	36.8	104.7	116.0	(9.7)	129.3	(10.3)
Depreciation and amortization	45.9	42.7	7.5	178.5	165.9	7.6	142.3	16.6
Food and beverage service	12.8	11.2	14.3	47.7	48.3	(1.2)	46.9	3.0
Other	41.9	40.1	4.5	161.2	170.3	(5.3)	173.1	(1.6)
New pilot contract transition costs	-	-	NM	35.8	-	NM	-	NM
	-	9.2	NM	-	12.9	NM	-	NM

Restructuring charges								
Fleet transition costs - MD-80	-	-	NM	-	47.5	NM	-	NM
Total mainline operating expenses	627.3	743.6	(15.6)	2,495.7	3,036.5	(17.8)	2,553.3	18.9
Purchased capacity costs	75.2	66.9	12.4	281.5	313.7	(10.3)	302.8	3.6
Total Operating Expenses	702.5	810.5	(13.3)	2,777.2	3,350.2	(17.1)	2,856.1	17.3
Operating Income (Loss)	42.3	(84.9)	NM	228.8	(128.9)	NM	213.8	NM
Interest income	9.4	13.1		38.6	51.3		64.8	
Interest expense	(20.6)	(25.0)		(88.1)	(92.5)		(86.2)	
Interest capitalized	1.6	4.1		7.3	20.2		25.7	
Other - net	2.5	(0.7)		(2.8)	(3.4)		(3.1)	
	(7.1)	(8.5)		(45.0)	(24.4)		1.2	
Income (Loss) Before Income Tax	$ 35.2	$ (93.4)	NM	$ 183.8	$ (153.3)	NM	$ 215.0	NM
Mainline Operating Statistics:								
Revenue passengers (000)	3,765	3,772	(0.2)	15,561	16,809	(7.4)	17,558	(4.3)
RPMs (000,000) "traffic"	4,550	4,302	5.8	18,362	18,712	(1.9)	18,451	1.4
ASMs (000,000) "capacity"	5,675	5,590	1.5	23,144	24,218	(4.4)	24,208	0.0
Passenger load factor	80.2 %	77.0 %	3.2pts	79.3 %	77.3 %	2.0pts	76.2 %	1.1pts
Yield per passenger mile	13.07 ¢	14.01 ¢	(6.7)	13.28 ¢	14.13 ¢	(6.0)	13.81 ¢	2.3
Operating revenues per ASM "RASM"	11.77 ¢	11.78 ¢	(0.1)	11.74 ¢	12.06 ¢	(2.7)	11.52 ¢	4.7
Change in Mileage Plan terms per ASM	-	-	NM	-	0.17 ¢	NM	-	NM
Passenger revenue per ASM “PRASM”	10.48 ¢	10.78 ¢	(2.8)	10.54 ¢	10.92 ¢	(3.5)	10.52 ¢	3.7
Operating expenses per ASM	11.05 ¢	13.30 ¢	(16.9)	10.78 ¢	12.54 ¢	(14.0)	10.55 ¢	18.9

Operating expenses per ASM, excluding fuel, new pilot contract transition costs, restructuring charges and fleet transition costs	8.53 ¢	7.80 ¢	9.4	8.26 ¢	7.49 ¢	10.2	7.50 ¢	(0.1)
Aircraft fuel cost per gallon	$ 1.91	$ 3.95	(51.6)	$ 1.81	$ 3.48	(48.0)	$ 2.08	67.3
Economic fuel cost per gallon	$ 2.26	$ 2.52	(10.3)	$ 2.05	$ 3.00	(31.7)	$ 2.20	36.4
Fuel gallons (000,000)	75.0	75.5	(0.7)	304.9	333.8	(8.7)	354.3	(5.8)
Average number of full-time equivalent employees	8,701	9,156	(5.0)	8,915	9,628	(7.4)	9,679	(0.5)
Aircraft utilization (blk hrs/day)	9.3	10.0	(7.0)	9.8	10.6	(7.5)	10.9	(2.8)
Average aircraft stage length (miles)	1,058	995	6.3	1,034	979	5.6	926	5.7
Operating fleet at period-end	115	110	5 a/c	115	110	5 a/c	115	(5) a/c
Purchased Capacity Operating Statistics:								
RPMs (000,000)	276	227	21.6	1,053	1,100	(4.3)	1,099	0.1
ASMs (000,000)	373	316	18.0	1,431	1,469	(2.6)	1,453	1.1
Passenger load factor	74.0 %	71.8 %	2.2pts	73.6 %	74.9 %	(1.3)pts	75.6 %	(0.7)pts
Yield per passenger mile	27.90 ¢	29.47 ¢	(5.3)	27.39 ¢	27.35 ¢	0.1	25.61 ¢	6.8
RASM	20.64 ¢	21.17 ¢	(2.5)	20.15 ¢	20.48 ¢	(1.6)	19.37 ¢	5.7
Operating expenses per ASM	20.16 ¢	21.17 ¢	(4.8)	19.67 ¢	21.35 ¢	(7.9)	20.84 ¢	2.4

NM = Not Meaningful

Table of Contents

ALASKA AIRLINES

Alaska reported income before income taxes of $183.8 million in 2009 compared to a loss before income taxes of $153.3 million in 2008.

Excluding certain items as noted in the table below, Alaska would have reported income before income taxes of $145.9 million in 2009, compared to $25.2 million in 2008. See the previous discussion under "Adjusted Non-GAAP Earnings and Per-Share Amounts" for additional information about these non-GAAP measures.

	Years Ended December 31	
(in millions)	2009	2008
Income before income taxes, excluding items below	$ 145.9	$ 25.2
Change in Mileage Plan terms	--	42.3
New pilot contract transition costs	(35.8)	--
Restructuring charges	--	(12.9)
Fleet transition costs – MD-80	--	(47.5)
Mark-to-market fuel hedge adjustments	73.7	(118.9)
Realized losses on hedge portfolio restructuring	--	(41.5)
Income (loss) before income taxes as reported	$ 183.8	$ (153.3)

The discussion below outlines significant variances between the two periods.

ALASKA REVENUES

Total operating revenues declined $215.3 million, or 6.7%, during 2009 compared to 2008. The changes are summarized in the following table:

	Years Ended December 31		
(in millions)	2009	2008	% Change
Passenger revenue—mainline	$ 2,438.8	$ 2,643.7	(7.8)
Freight and mail	91.5	99.3	(7.9)
Other—net	187.3	135.2	38.5