

ALASKA AIR GROUP INC
Form 10-K
February 21, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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, 2011

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
(I.R.S. Employer Identification No.)

19300 International Boulevard, Seattle, Washington 98188
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 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

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 No

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

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(§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 T 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.

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

Large accelerated filer 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

As of January 31, 2012, shares of common stock outstanding totaled 35,453,202. The aggregate market value of the shares of common stock of Alaska Air Group, Inc. held by nonaffiliates on June 30, 2011, was approximately \$2.5 billion (based on the closing price of \$68.46 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 2011 Annual Meeting of Shareholders	Part III

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As used in this Form 10-K, the terms “Air Group,” the “Company,” “our,” “we” and “us,” 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.”

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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.

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PART I

ITEM 1. OUR BUSINESS

Alaska Air Group, Inc. (Air Group, the Company, our, we or us) is a Delaware corporation incorporated in 1985 and has two principal subsidiaries: Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon), which provide scheduled air transportation for passengers and cargo throughout the United States, Canada and Mexico. During 2011, we provided air service to more than 24 million passengers and flew to more than 100 destinations.

The domestic airline industry is fiercely competitive. To set ourselves apart we have focused on outstanding operational performance and customer service as evidenced by being ranked “Highest in Customer Satisfaction among Traditional Network Carriers” by J.D. Power and Associates for four consecutive years. We believe we differentiate ourselves in a number of ways.

First, we offer an award-winning frequent flyer program, the Alaska Airlines Mileage Plan™. Members can earn and redeem miles on Alaska, Horizon, and a network of 15 airline partners around the globe, including Delta Air Lines and American Airlines in the U.S. Our Mileage Plan has earned recognition as the "Frequent Flyer Program of the Year" five times in the Freddie Awards. In addition, our Mileage Plan Visa card has been named “Best Loyalty Credit Card in the Americas” for two years running.

Second, we are recognized as having industry-leading on-time performance and other key operational metrics. We are the only airline in the country with a Baggage Service Guarantee and recently launched new mobile applications for Android and iPhone smart phones that provide customers with new functionality aimed at making their travel experience more convenient and hassle-free. Improving the travel experience, particularly in the airport environment, is an area we will continue to focus on in 2012.

Third, we aim to provide a high quality onboard experience to our passengers. For example, we equipped our fleet of 737 aircraft with onboard Wi-Fi capability. With 98 percent of the fleet equipped, Alaska is an industry leader in this area. The Company also continues to focus on serving high-quality food and beverage products on board, using local products from the Pacific Northwest and Hawaii. Our Northern Bites meals-for-purchase program had record sales in 2011, and on February 1, 2012 we introduced Starbucks coffee on on Alaska Flights. Starbucks has been featured on Horizon flights for many years. Additionally, Alaska recently took delivery of its first new 737 featuring the Boeing Dreamliner-inspired Sky Interior. All future deliveries will include this new interior.

Fourth, we want to be known for our environmental leadership. In the fall of 2011, our airlines were the first U.S. carriers to operate multiple scheduled biofuel flights. We flew over 75 commercial flights between Seattle - Washington D.C. and Seattle - Portland using a 20 percent aviation biofuel blend, refined from used cooking oil. These routes were selected to demonstrate the use of biofuel on a transcontinental route on a Boeing 737 and a short-haul operation using the Bombardier Q400. Our inflight recycling programs divert an estimated 800 tons of mixed recyclables from local landfills each year. In 2011, Horizon flight attendants collected and diverted 90 percent of all recyclable materials, with Alaska flight crews setting a goal to divert 70 percent of all recyclable materials in 2012. Further, we are spearheading a "Greener Skies" initiative to implement GPS technology which will allow airlines to use more efficient and environmentally-friendly flight paths, resulting in improved flight procedures and reduced emissions.

And finally, we are striving to establish more direct relationships with our customers by engaging them whenever possible at alaskaair.com. Our completely re-designed website introduced in 2011 is now among the industry's fastest and is better equipped to offer a full range of travel products and services to our customers. Our focus is to drive more

visitors to the site through enhanced online search efforts, email marketing, an expanded social media presence and other digital marketing efforts. As a result, alaskaair.com's share of total bookings is now over 50 percent.

Although Alaska and Horizon both operate as airlines, their business plans, competition, and economic risks differ substantially. Alaska Airlines is an Alaska corporation that was organized in 1932 and incorporated in 1937. Horizon Air Industries is a Washington corporation that first began service and was incorporated in 1981. Horizon was acquired by Air Group in 1986. Alaska operates a fleet of passenger jets ("mainline operations") and contracts with Horizon, SkyWest Airlines, Inc. (SkyWest) and Peninsula Airways, Inc. (PenAir) for regional capacity under which Alaska receives all passenger revenue from those flights. Horizon operates a fleet of turboprop aircraft and sells all of its capacity to Alaska pursuant to a capacity purchase arrangement (the Horizon CPA). The Horizon CPA reflects what the Company believes are current market rates received by other regional carriers for similar flying. Amounts paid by Alaska to Horizon are available to pay for various Horizon operating expenses such as crew expenses, maintenance, and aircraft ownership costs.

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Effective January 1, 2011, Horizon's business model changed such that 100% of its capacity is sold to Alaska under the Horizon CPA. As is typical for similar arrangements, certain costs such as landing fees, selling and distribution costs, and fuel costs directly related to regional flights operated by Horizon are now recorded by Alaska. Because of this change, Horizon's revenues and expenses and Alaska's Regional revenues and expenses have changed significantly on a year-over-year basis.

FOUR CONSECUTIVE YEARS OF BEING RANKED "HIGHEST IN CUSTOMER SATISFACTION AMONG TRADITIONAL NETWORK CARRIERS" BY J.D. POWER AND ASSOCIATES

MAINLINE

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 thirteen 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 2011, we carried nearly 18 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 2011, Alaska's leading airports are Seattle, Los Angeles, Anchorage and Portland. Based on 2011 revenues, the leading nonstop routes are Seattle-Anchorage, Seattle-Los Angeles, and Seattle-Las Vegas. At December 31, 2011, Alaska's operating fleet consisted of 117 Boeing 737 jet aircraft, compared to 114 aircraft as of December 31, 2010.

The percentage of mainline passenger traffic by market is presented below:

	2011	2010	2009	
West Coast	31	% 33	% 36	%
Within Alaska and between Alaska and the U.S. mainland	17	% 19	% 21	%
Transcon/midcon	22	% 24	% 23	%
Hawaii	19	% 14	% 9	%
Mexico	9	% 8	% 9	%
Canada	2	% 2	% 2	%
Total	100	% 100	% 100	%
Average Stage Length	1,114	1,085	1,034	

REGIONAL

In 2011, our regional operations carried nearly 7 million revenue passengers, primarily in the states of Washington, Oregon, Idaho and California. Horizon is the largest regional airline in the Pacific Northwest and represented 87%, 98%, and 98%, of Air Group's regional revenue passengers during 2011, 2010, and 2009, respectively.

Based on 2011 passenger enplanements on regional aircraft, the leading airports are Seattle, Portland, Spokane, and Boise. Based on revenues in 2011, the leading nonstop routes are Portland-Seattle, Spokane-Seattle, and Seattle-Vancouver, British Columbia, Canada. At December 31, 2011, Horizon's operating fleet consisted of 48 Bombardier Q400 turboprop aircraft. Horizon flights are listed under Alaska's designator code in airline reservation systems, and in most other customer-facing locations.

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The percentage of regional passenger traffic by market is presented below:

	2011	2010	2009	
West Coast	67	% 70	% 70	%
Pacific Northwest	21	% 19	% 20	%
Canada	8	% 8	% 7	%
Within Alaska	2	% 2	% 2	%
Mexico	2	% 1	% 1	%
Total	100	% 100	% 100	%
Average Stage Length	309	333	327	

AIR GROUP CAPACITY

We attempt to deploy aircraft into the network in a way that best optimizes our revenues and profitability, reduces our seasonality, and takes advantage of demand in areas where other carriers have either exited or don't have the ability to serve.

The percentage of our capacity by market is as follows:

	2011	2010	2009	
West Coast	37	% 41	% 45	%
Alaska	18	% 19	% 20	%
Transcon/midcon	19	% 19	% 17	%
Hawaii	16	% 11	% 7	%
Mexico	9	% 8	% 8	%
Canada	1	% 2	% 3	%
Total	100	% 100	% 100	%

INDUSTRY CONDITIONS, COMPETITION, AND ALLIANCES

GENERAL

The airline industry is highly competitive and has historically been characterized by low profit margins subject to various uncertainties. This includes general economic conditions, volatile fuel prices, industry instability, intense competition, a largely unionized work force, the need to finance large capital expenditures and the related availability of capital, government regulation, and potential aircraft incidents. Airlines have 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 operating and financial results. 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.

YEAR IN REVIEW — 2011

2011 was characterized by continued industry capacity discipline with an increase in passenger traffic. This allowed for higher load factors and yields, leading others in the industry to report higher revenue and in some cases, stronger adjusted earnings compared to 2010. Jet fuel prices increased significantly in 2011, and that continues to be an area of concern in 2012.

During 2011, our key initiative was to optimize revenue. We continued to redeploy capacity to better match demand, resulting in record passenger load factors. We also worked to lower non-fuel unit costs to better compete with carriers that have lower cost structures. Along with our continued focus on customer service and our strong operational performance, we reported record adjusted financial results that again were among the best in the industry.

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OUR ABILITY TO REDEPLOY CAPACITY, COMBINED WITH LOWER NON-FUEL UNIT COSTS, OUR CONTINUED FOCUS ON CUSTOMER SERVICE, AND OUR INDUSTRY LEADING ON-TIME PERFORMANCE RESULTED IN 2011 RECORD ADJUSTED FINANCIAL RESULTS THAT WERE AGAIN 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 and are impacted by changes in both the price of crude oil as well as the West Coast refining margin, which represent the price of refining crude oil into jet fuel and can vary by region in the U.S.

The price of crude oil spiked in 2008 with a high of nearly \$150 per barrel in July 2008 and dropped significantly to an average of \$62 per barrel in 2009. We saw upward pressure on fuel prices again with an average crude oil price of just over \$80 per barrel in 2010 and \$95 per barrel in 2011. For us, a \$1 per barrel increase in the price of oil equates to approximately \$9 million of additional fuel cost annually. Said another way, a one-cent change in our fuel price per gallon will impact our expected annual fuel cost by approximately \$4 million per year.

While West Coast refining margins are a smaller portion of the overall price of jet fuel than crude oil, they also contributed to the overall price volatility in recent years. Refining margin prices reached a high of nearly \$45 per barrel in May 2008, before they dropped to an average price of \$24 per barrel in 2009. Refining margins prices dropped further in 2010 to average \$14 a barrel, but then jumped upwards in 2011 and averaged \$33 a barrel for the year. 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.

We refer to the price we pay for fuel at the airport, including applicable taxes, as our “raw” fuel price. 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 30% to 50% 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.

Our average raw fuel cost per gallon increased 36% in 2011, 27% in 2010, and declined 43% in 2009.

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. Both call options and swaps effectively cap our pricing for the crude oil and refining margin components, limiting our exposure to increasing fuel prices for about half of our planned fuel consumption. With the 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. The swap contracts do not require an upfront premium, but do expose us to future cash outlays in the event actual prices are below the swap price during the hedge period.

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

We believe that operating fuel-efficient aircraft is the best hedge against high fuel prices. Alaska operates an all-Boeing 737 fleet. Horizon completed its transition to an all-Q400 turboprop fleet in 2011. 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 76.6 ASMs/g in 2011. Similarly, Horizon’s fuel burn has improved from 51.7 ASMs/g in 2006 to 59.3 ASMs/g in 2011.

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

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,

• fares,

• flight schedules,

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- customer service,
- routes served,
- frequent flier programs,
- on-time arrivals,
- baggage handling,
- on-board amenities,
- type of aircraft, and
- codesharing relationships.

We carry approximately 4% of all U.S. domestic passenger traffic. We compete with one or more domestic or foreign airlines on most of our routes, including both major legacy carriers and low-cost carriers.

Due to its short-haul markets, our regional operations 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 changed the need for, or frequency of face-to-face business meetings.

ALLIANCES WITH OTHER AIRLINES

We have marketing alliances with a number of airlines that provide reciprocal frequent flyer mileage credit and redemption privileges as well as codesharing 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;
- giving 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 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.

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Our marketing alliances with other airlines 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 / SkyWest
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	Yes
Delta Air Lines ^(a)	Yes	Yes	Yes
Emirates Airline	Yes	No	No
Icelandair	Yes	No	Yes
KLM	Yes	No	Yes
Korean Air	Yes	No	Yes
Lan S.A.	Yes	No	Yes
Air Pacific ^(b)	Yes	No	Yes
Qantas	Yes	No	Yes
Regional Airlines			
SkyWest ^(b)	Yes	Yes	No
Era Alaska	Yes	Yes	No
PenAir ^(b)	Yes	Yes	No
Kenmore Air ^(b)	Yes	No	No

^(a) Alaska has codeshare agreements with the Delta Connection carriers SkyWest, ASA, Pinnacle, Mesaba, Comair and Compass as part of its agreement with Delta.

^(b) 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.

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: 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 us to 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, AZ, Kent, WA, and Boise, ID. We generally charge a \$15 fee for booking reservations through these call centers.

Our sales by channel are as follows:

2011	2010
------	------

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Alaskaair.com	51	% 48	%
Traditional agencies	28	% 28	%
Online travel agencies	13	% 15	%
Reservation call centers	8	% 9	%
Total	100	% 100	%

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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. However, we have taken steps over the past few years to reduce the seasonality of our operations by adding flights to leisure destinations in Hawaii and Mexico.

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.

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.

We had 12,806 (9,640 at Alaska and 3,166 at Horizon) active full-time and part-time employees at December 31, 2011, compared to 12,039 (9,013 at Alaska and 3,022 at Horizon) at December 31, 2010. Wages, salaries and benefits (including variable incentive pay) represented approximately 41% and 43% of our total non-fuel operating expenses and 27% and 31% of our total expenses in 2011 and 2010, respectively.

At December 31, 2011, labor unions represented 83% of Alaska's and 47% of Horizon's employees. Our relations with our U.S. 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.

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Alaska's union contracts at December 31, 2011 were as follows:

Union	Employee Group	Number of Active Employees	Contract Status
Air Line Pilots Association International (ALPA)	Pilots	1,393	Amendable 4/1/2013
Association of Flight Attendants (AFA)	Flight attendants	2,794	In Negotiations
International Association of Machinists and Aerospace Workers (IAM)	Ramp service and stock clerks	700	Amendable 7/17/2012
IAM	Clerical, office and passenger service	2,328	Amendable 1/1/2014
Aircraft Mechanics Fraternal Association (AMFA)	Mechanics, inspectors and cleaners	626	Amendable 10/17/2016
Mexico Workers Association of Air Transport	Mexico airport personnel	92	Amendable 9/1/2013
Transport Workers Union of America (TWU)	Dispatchers	36	Amendable 3/24/2015

Horizon's union contracts at December 31, 2011 were as follows:

Union	Employee Group	Number of Active Employees	Contract Status
International Brotherhood of Teamsters (IBT)	Pilots	590	Amendable 12/14/2015
AFA	Flight attendants	504	In Negotiations
IBT	Mechanics and related classifications	327	Amendable 12/16/2014
TWU	Dispatchers	18	Amendable 8/26/2014
National Automobile, Aerospace, Transportation and General Workers	Station personnel in Van-couver and Victoria, BC, Canada	59	Expires 2/13/2013

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 are as follows:

Name	Position	Age	Air Group or Subsidiary Officer Since
William Ayer	Chairman, President and Chief Executive Officer of Alaska Air Group, Inc., Chairman and Chief Executive Officer of Alaska Airlines, Inc. and Chairman and Chief Executive Officer of Horizon Air Industries, Inc.	57	1985
Brandon Pedersen	Vice President/Finance and Chief Financial Officer of Alaska Air Group, Inc. and Alaska Airlines, Inc.	45	2003
Keith Loveless	Vice President/Legal and Corporate Affairs, General Counsel and Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc.	55	1996
Bradley Tilden	President of Alaska Airlines, Inc.	51	1994

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Glenn Johnson	President of Horizon Air Industries, Inc.	53	1991
Benito Minicucci	Executive Vice President/Operations and Chief Operating Officer of Alaska Airlines, Inc.	45	2004
Kelley Dobbs	Vice President/Human Resources of Alaska Airlines, Inc.	45	2004

Mr. Ayer has been Air Group's President since February 2003 and became Chairman and Chief Executive Officer in May 2003. He has also served as Alaska Airlines' Chairman since February 2003, as Chief Executive Officer since January 2002 and was

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President from November 1997 to December 2008. He has served as Horizon Air Industries' Chairman and Chief Executive Officer since June 2010. 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 Industries from January 1995. Mr. Ayer also serves on the boards of 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. In January 2012, Mr. Ayer was appointed to the University of Washington Board of Regents. On February 16, 2012, the Company announced that Mr. Ayer will resign as CEO but will remain as executive chairman of the board, effective May 15, 2012.

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. He was elected Vice President/Finance and Chief Financial Officer of Alaska Air Group and Alaska Airlines in June 2010. 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 Air Group and Alaska Airlines in 1994, Chief Financial Officer in February 2000, Executive Vice President/Finance and Chief Financial Officer 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 and was elected to the Air Group Board in 2010. On February 16, 2012, the Company announced the appointment of Mr. Tilden as the Chief Executive Officer, effective May 15, 2012.

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 was elected President of Horizon Air Industries in June 2010. 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, Vice President/Human Resources and Labor Relations in 2009, and Vice President/Human Resources in 2011. She is a member of Air Group's Management Executive Committee.

REGULATION

GENERAL

The airline industry is highly regulated.

The Department of Transportation (DOT), the Federal Aviation Administration (FAA) and the Transportation Security Administration (TSA) 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, marketing alliance agreements between major domestic carriers, international and some domestic route authorities, Essential Air Service market subsidies, and carrier liability for personal or property damage. International treaties may also contain restrictions or requirements for flying outside of the U.S. and impose different carrier liability limits than those applicable to domestic flights. The DOT has recently been active in implementing a variety of “passenger protection”

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regulations, covering subjects such as advertising, passenger communications, denied boarding compensation and tarmac delay response. As of January 26, 2012, carriers must adhere to DOT's full-fare advertising rule, which requires quoted fares to include all applicable government taxes and fees.

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.

TSA: Airlines serving the U.S. must operate a TSA-approved Aircraft Operator Standard Security Program (AOSSP), and comply with TSA Security Directives (SDs) and regulations. Airlines are subject to enforcement actions that are brought by the TSA from time to time for alleged violations of the AOSSP, SDs or security regulations. We are not aware of any enforcement proceedings that could either materially affect our financial position or impact our authority to operate. Under TSA authority, we are also required to collect a September 11 Security Fee of \$2.50 per enplanement from passengers and remit that sum to the government to fund aviation security measures. Carriers also pay the TSA a security infrastructure fee to cover passenger and property screening costs. These security infrastructure fees amounted to \$12.6 million each year in 2011, 2010 and 2009.

The Department of Justice and DOT have 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 fares without governmental regulation and the industry is characterized by vigorous price competition. International fares and rates are also subject to the jurisdiction of the governments of the foreign countries we serve.

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 there will be legislation in the future to reduce carbon and other greenhouse gas emissions. Alaska and Horizon have transitioned to more fuel-efficient aircraft fleets, thereby greatly reducing our total emissions.

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.

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CUSTOMER SERVICE

Along with other domestic airlines, we have implemented a customer service commitment plan to address a number of service goals and regulatory requirements, including, but not limited to, goals relating to lowest fare availability, delays, cancellations and diversions, baggage delivery and liability, guaranteed fares and ticket refunds. As a testament to our service, Alaska has won the JD Power and Associates award for "Highest in Customer Satisfaction Among Traditional Network Carriers" for the past four years.

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.

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.

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.

We have adopted an enterprise wide Risk Analysis and Oversight Program designed to identify the various risks faced by the organization, assign responsibility for managing those risks to individual executives within management ranks as well as align these risks with appropriate Board level oversight. These enterprise level identified risks have been aligned to the risk factors discussed below.

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 or an aircraft operated by one of our codeshare partners or CPA carriers

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 claims from injured passengers, by-standers 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, as do our codeshare partners and CPA carriers. 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 aircraft, 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

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issued regulations that have required significant expenditures relating to the maintenance and operation of airlines and consumer protections. 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.

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.

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 and Horizon have subcontracted their 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. 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 us to renegotiate existing agreements on less favorable terms. These events could result in disruptions in our operations or increases in our cost structure.

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.

Other conditions that might impact our operations include:

- air traffic congestion at airports or other air traffic control problems;

- adverse weather conditions;

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- 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

The airline industry is highly competitive. If we cannot successfully compete in the marketplace, our business, financial condition and operating results will be materially adversely affected.

We face significant competition with respect to routes, services, and fares. Some of our competitors have lower costs than we do and provide service to destinations served by us. 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. If we are unable to reduce our costs over the long-term and achieve sustained targeted return on invested capital, we will likely not be able to grow our business in the future or weather industry downturns and therefore our financial results may suffer.

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, Hawaii and Anchorage. A significant portion of our flights occur to and from our Seattle hub. In 2011, passengers to and from Seattle accounted for 63% 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.

Economic uncertainty or another recession would likely impact demand for our product and could harm our financial condition and results of operations.

The recent U.S. and global economic recession resulted in a decline in demand for air travel. While some economic indicators are showing signs of growth, unemployment remains high in some of our key markets. Given that the strength of the U.S. and global economies have an impact on the demand for air travel, a long-term economic slump could result in a need to adjust our capacity plans, which could harm our business, financial condition and results of operations.

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 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.

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

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program. The loss of a significant partner or certain partner flights through bankruptcy, consolidation, or otherwise, could have a negative effect on our revenues or the attractiveness of our Mileage Plan, which we believe is a source of competitive advantage.

In November 2011, AMR Corporation, the parent of American Airlines, filed for bankruptcy protection. We do not believe the bankruptcy will impact our marketing agreement with American Airlines.

INFORMATION TECHNOLOGY

We rely heavily on automated systems to operate our business, and a failure or disruption of these systems or 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 check-in kiosks, 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 or service disruptions could reduce the attractiveness of our services and cause our customers to do business with another airline. In addition, we rely on other automated systems for crew scheduling, flight dispatch, and other operational needs. Disruptions, untimely recovery, or a breach of these systems could result in the loss of important data, an increase of our expenses, an impact on our operational performance, or a possible temporary cessation of our operations.

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.

FINANCIAL CONDITION AND FINANCIAL MARKETS

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 34% and 27% of total operating expenses for the years ended December 31, 2011 and 2010, 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 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, 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 consolidated statements of operations. The calculation of pension expense is dependent on many assumptions that are more fully described in "Critical Accounting Estimates" and Note 1 to our consolidated financial statements.

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

Although we have reduced our long-term debt balance significantly over the past three years, we have, and may 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.

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” for more detailed information about our obligations and commitments.

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 September 30, 2013. 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.

BRAND AND REPUTATION

We may not be successful in implementing important strategic initiatives, which may negatively impact our brand and reputation.

We continue to focus on strategic initiatives designed to increase our brand perception to a diverse and evolving demographic of airline travelers. These efforts include significant improvements to our airport space at Los Angeles International Airport (LAX) and efforts to increase our direct customer relationships through improvements to our online purchasing portal (alaskaair.com), social media, and customer loyalty programs (Club 49).

If these efforts are unsuccessful or they negatively affect our reputation with our existing customer base, we may experience an adverse impact on our business and financial results. Furthermore, with the ongoing Horizon brand phase-out, there is a potential that we may lose some brand recognition from our customers in areas that Horizon has historically served.

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LABOR RELATIONS AND LABOR STRATEGY

A significant increase in labor costs, unsuccessful attempts to strengthen our relationships with union employees, or loss of key personnel could adversely affect our business and results of operations.

Labor costs are a significant component of our total expenses, accounting for approximately 27% and 31% of our total operating expenses in 2011 and 2010, respectively. 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.

As of December 31, 2011, labor unions represented approximately 83% of Alaska's and 47% of Horizon's employees. Although we have been successful in maturing communications, negotiating approaches, and other strategies to enhance workforce engagement in the Company's long-term vision, future uncertainty around open contracts could be a distraction, affecting employee focus in our business and diverting management's attention from other projects and issues.

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, sustain employee engagement in the Company's strategic vision, or if we are unsuccessful at implementing succession plans for our key staff, we may be unable to grow or sustain our business. In such case, our operating results and business prospects could be harmed.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

AIRCRAFT

The following table describes the aircraft we operate and their average age at December 31, 2011:

Aircraft Type	Passenger Capacity	Owned	Leased	Total	Average Age in Years
B737-400	144	3	21	24	16.0
B737-400F ^(a)	—	1	—	1	12.8
B737-400C ^(a)	72	5	—	5	19.3
B737-700	124	17	—	17	11.5
B737-800	157	48	10	58	3.9
B737-900	172	12	—	12	9.4
Q400	76	33	15	48	6.1
Total		119	46	165	

^(a) F-Freighter; C-Combination freighter/passenger

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 Resources."

Alaska's leased 737-400 and 737-800 aircraft have lease expiration dates between 2013 and 2016, and between 2015 and 2021, respectively. Horizon's leased Q400 aircraft have expiration dates in 2018. Horizon also has two owned and 14 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.

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The following table displays the currently anticipated fleet counts as of the end of each quarter in 2012:

	31-Mar-12	30-Jun-12	30-Sep-12	31-Dec-12
B737-400	24	24	24	24
B737-400F ^(a)	1	1	1	1
B737-400C ^(a)	5	5	5	5
B737-700	17	17	17	17
B737-800	60	61	61	61
B737-900	12	12	12	12
B737-900ER	—	—	—	3
Q400 ^(b)	48	50	49	48
Totals	167	170	169	171

^(a) F-Freighter; C-Combination freighter/passenger

^(b) Includes two additional aircraft authorized subsequent to December 31, 2011

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, WA. 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 a corporate headquarters complex. Alaska also leases a stores warehouse, and office space for a customer service and reservation facility in Kent, WA. Alaska's major facilities outside of Seattle include a regional headquarters building, an air cargo facility and a hangar/office facility in Anchorage, AK, as well as leased reservations facilities in Phoenix, AZ. and Boise, ID. 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, Bellingham, Eugene, Los Angeles, Medford, Redmond, Seattle, and Spokane.

ITEM 3. LEGAL PROCEEDINGS

We are a party to routine litigation matters incidental to our business. 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.

The SEC has formally notified Mr. Ayer that the inquiry discussed in our 2010 Form 10-K has been closed.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

As of December 31, 2011, there were 35,474,775 shares of common stock of Alaska Air Group, Inc. issued and outstanding and 3,105 shareholders of record. We also held 2,391,747 treasury shares at a cost of \$125.3 million. We have not paid dividends on the common stock since 1992 and have no plans to do so in the immediate future. Our common stock is listed on the New York Stock Exchange (symbol: ALK).

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

	2011		2010	
	High	Low	High	Low
First Quarter	\$65.00	\$56.15	\$42.59	\$31.24
Second Quarter	70.07	59.00	54.13	37.03
Third Quarter	70.61	51.79	54.66	42.00
Fourth Quarter	77.14	51.10	59.59	44.86

On February 15, 2012, the board of directors declared a two-for-one split of the Company's common stock to be accomplished by means of a stock distribution. The additional shares will be distributed on March 16, 2012, to the shareholders of record on March 2, 2012. The stock split will increase the Company's outstanding shares from approximately 35.5 million shares to about 71.0 million shares. Our historical outstanding shares will be recast upon the distribution.

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	Total Number of Shares (or units) Purchased as Part of Publicly Announced Plans or Programs	Maximum remaining dollar value of shares that can be purchased under the plan
October 1, 2011 – October 31, 2011 ^(a)	132,000	\$59.05	132,000	
November 1, 2011 – November 30, 2011 ^(a)	73,500	66.31	73,500	
December 1, 2011 – December 31, 2011 ^(a)	73,500	71.62	73,500	
Total	279,000	\$64.27	279,000	\$1,702,870

^(a) Purchased pursuant to a \$50 million repurchase plan authorized by the Board of Directors in June 2011. The plan was completed in January 2012.

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PERFORMANCE GRAPH

The following graph compares our cumulative total stockholder return since December 31, 2006 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, 2006.

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ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

	2011	2010	2009	2008	2007
CONSOLIDATED OPERATING RESULTS					
(audited)					
Year Ended December 31 (in millions, except per share amounts):					
Operating Revenues	4,317.8	3,832.3	3,399.8	3,662.6	3,506.0
Operating Expenses	3,868.9	3,360.7	3,132.4	3,834.8	3,295.1
Operating Income (Loss)	448.9	471.6	267.4	(172.2)	210.9
Nonoperating expense, net of interest capitalized ^(a)	(55.2)	(65.7)	(64.5)	(41.0)	(10.4)
Income (loss) before income tax	393.7	405.9	202.9	(213.2)	200.5
Net Income (Loss)	244.5	251.1	121.6	(135.9)	124.3
Average basic shares outstanding	35.878	35.822	35.815	36.343	40.125
Average diluted shares outstanding	36.710	36.786	36.154	36.343	40.424
Basic earnings (loss) per share	6.81	7.01	3.39	(3.74)	3.10
Diluted earnings (loss) per share	6.66	6.83	3.36	(3.74)	3.07
CONSOLIDATED FINANCIAL POSITION					
(audited)					
At End of Period (in millions):					
Total assets	\$5,195.0	\$5,016.6	\$4,996.2	\$4,835.6	\$4,490.9
Long-term debt and capital lease obligations, net of current portion	1,099.0	1,313.0	1,699.2	1,596.3	1,124.6
Shareholders' equity	1,173.2	1,105.4	872.1	661.9	1,025.4
OPERATING STATISTICS (unaudited)					
Consolidated: ^(b)					
Revenue passengers (000)	24,790	23,334	22,320	24,199	25,110
Revenue passenger miles (RPM) (000,000) "traffic"	25,032	22,841	20,811	21,390	21,411
Available seat miles (ASM) (000,000) "capacity"	29,627	27,736	26,501	27,908	28,256
Load factor	84.5 %	82.4 %	78.5 %	76.6 %	75.8 %
Yield	15.78 ¢	15.27 ¢	14.93 ¢	15.76 ¢	15.20 ¢
Passenger revenues per ASM (PRASM)	13.33 ¢	12.58 ¢	11.73 ¢	12.08 ¢	11.51 ¢
Operating revenues per ASM (RASM)	14.57 ¢	13.82 ¢	12.83 ¢	13.12 ¢	12.41 ¢
Operating expenses per ASM, excluding fuel and noted items (CASMex) ^(c)	8.55 ¢	8.82 ¢	9.20 ¢	8.47 ¢	8.56 ¢
Average number of full-time equivalent employees (FTE)	11,840	11,696	12,223	13,327	13,576
Mainline:					
Revenue passengers (000)	17,810	16,514	15,561	16,809	17,558
RPMs (000,000) "traffic"	22,586	20,350	18,362	18,712	18,451
ASMs (000,000) "capacity"	26,517	24,434	23,144	24,218	24,208
Load factor	85.2 %	83.3 %	79.3 %	77.3 %	76.2 %
Yield	14.06 ¢	13.58 ¢	13.28 ¢	14.13 ¢	13.81 ¢
PRASM	11.98 ¢	11.31 ¢	10.54 ¢	10.92 ¢	10.52 ¢
CASMex ^(c)	7.60 ¢	7.85 ¢	8.26 ¢	7.49 ¢	7.50 ¢
Operating fleet at period-end	117	114	115	110	115
Regional: ^(d)					
Revenue passengers (000)	6,980	6,820	6,759	7,390	7,552

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RPMs (000,000) "traffic"	2,446		2,491		2,449		2,678		2,960
ASMs (000,000) "capacity"	3,110		3,302		3,357		3,690		4,048
Load factor	78.6	%	75.4	%	73.0	%	72.6	%	73.1
Yield	31.66	¢	29.11	¢	27.30	¢	27.20	¢	23.86
PRASM	24.90	¢	21.96	¢	19.92	¢	19.74	¢	17.45
Operating fleet at period-end (Horizon only)	48		54		58		59		70

(a) Includes capitalized interest of \$12.5 million, \$6.2 million, \$7.6 million, \$23.2 million, and \$27.8 million for 2011, 2010, 2009, 2008, and 2007, respectively.

(b) Includes flights operated by SkyWest beginning in May 2011 and flights operated by PenAir under Capacity Purchase Agreements (CPA).

(c) See reconciliation of this measure to the most directly related GAAP measure in the "Results of Operations" section.

(d) Data presented includes information related to regional CPAs, except for operating fleet.

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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 2011 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 our operations 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 is also included here. This section includes forward-looking statements regarding our view of 2012.

• **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.

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

YEAR IN REVIEW

Our 2011 consolidated pretax income was \$393.7 million compared to \$405.9 million in 2010. The \$12.2 million decline was primarily due to the \$396.8 million increase in aircraft fuel expense and \$111.4 million increase in other operating expenses, partially offset by the \$485.5 million improvement in revenues. The increase in fuel cost was driven by the 36.1% increase in raw cost per gallon on a 5.6% increase in consumption. Our improvement in revenues was primarily due to a 9.6% increase in traffic and a 3.3% increase in yield.

See "Results of Operations" below for further discussion of changes in revenues and operating expenses and our reconciliation of Non-GAAP measures to the most directly comparable GAAP measure.

Accomplishments and Highlights

Accomplishments and highlights from 2011 include:

• We reported record adjusted earnings for 2011.

• Alaska and Horizon continued their excellent operational performance again in 2011 as measured by on-time arrivals and completion rate as reported to the Department of Transportation (DOT). As a result, we were awarded the 2011 On-Time Performance Service Award among major North American Airlines by FlightStats.com for the second

consecutive year.

For the fourth year in a row, Alaska Airlines ranked “Highest in Customer Satisfaction among Traditional Network Carriers” in 2011 by J.D. Power and Associates.

We were the first North America carrier to receive the Joseph S. Murphy Industry Service Award for outstanding public and community service by Air Transport World magazine.

For the year, the Wall Street Journal named Alaska Airlines the best performing carrier in the U.S. in its annual Middle Seat analysis.

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• We won the Seattle Business Magazine 2011 Green Award, in the Large Services company category.

• During the year, we reached a five-year agreement with the Aircraft Mechanics Fraternal Association (AMFA) representing the aircraft technicians.

• For the year, our employees earned \$71.9 million in incentive pay for meeting certain operational and financial goals. We also contributed \$133.3 million to Alaska's defined-benefit pension plans.

Horizon Fleet Transition

To strengthen the regional operations we implemented several changes in 2011, including: Unifying our external brand to the Alaska Airlines brand, Horizon became a 100% CPA carrier, Horizon transitioned to an all-Q400 fleet, Horizon subleased CRJ-700 aircraft and removed all residual inventory, Horizon outsourced certain activities to third parties, and a limited number of long stage-length routes were transitioned to SkyWest.

New Markets

In 2011, we added several non-stop routes to our overall network as follows:

New Non-Stop Routes Between	Frequency (Weekly)	Start Date
Bellingham to Honolulu	Daily	1/7/2011
Lihue to San Jose	3x weekly	3/27/2011
Lihue to Oakland	4x weekly	3/28/2011
Billings to Portland	Daily (seasonal)	6/5/2011
Missoula to Portland	Daily (seasonal)	6/5/2011
San Diego to Honolulu	Daily	11/17/2011

We will also add new cities and non-stop routes in 2012 as follows:

New Non-Stop Routes Between	Frequency (Weekly)	Start Date
San Jose to Palm Springs	Daily (seasonal)	2/17/2012
Seattle to Kansas City	Daily	3/12/2012
Oakland to Honolulu	Daily	4/10/2012
San Jose to Honolulu	Daily	4/10/2012
Portland to Long Beach	Daily	3/12/2012
San Diego to Santa Rosa	Daily	6/4/2012
San Diego to Fresno	2x Daily	6/4/2012
San Diego to Monterey	Daily	6/4/2012
Reno to San Jose	2x Daily	6/4/2012
Portland to Bellingham	Daily (seasonal)	6/4/2012
Portland to Bozeman	Daily (seasonal)	6/4/2012
Portland to Santa Barbara	Daily (seasonal)	6/4/2012
Seattle to Philadelphia	Daily	6/11/2012
Seattle to Fort Lauderdale (replaces Seattle to Miami)	Daily	7/16/2012

The changes above, when combined with the significant number of network changes over the last few years, have diversified our network and made us less dependent on our historical markets in the State of Alaska and up and down the West Coast. We believe our smaller size makes us more nimble than some of our larger competitors, gives us a closer connection with our customers and allows us to identify and respond to market opportunities quickly.

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Stock Repurchase

In 2011, we repurchased 1,309,300 shares of our common stock for \$79.5 million under the \$50 million repurchase plans authorized by the our Board of Directors in June 2010 and June 2011. Since 2007, we have repurchased 8.4 million shares of common stock under such programs for \$262 million for an average price of approximately \$31 per share.

Outlook

Our primary focus every year is to run safe, compliant and reliable operations at our airlines. In addition to our primary objective, our key initiative in 2012 is to focus on the customer travel experience. Our specific focus will be on providing information and mobile capabilities to our customers as well as to speed them through the airport on the day of travel.

Our biggest concern for 2012 is the rising cost of fuel. However, with our fuel-efficient aircraft and our fuel hedge portfolio, we believe we are better prepared to handle those rising costs than others in the industry.

Our advance bookings suggest our load factors will be up 2.5 pts in February and 2.5 pts in March compared to the same periods in 2011 on an expected 3.5% increase in capacity for the first quarter of 2012.

Subsequent Events

On February 15, 2012, the board of directors declared a two-for-one split of the Company's common stock to be accomplished by means of a stock distribution. The additional shares will be distributed on March 16, 2012, to the shareholders of record on March 2, 2012. The stock split will increase the Company's outstanding shares from approximately 35.5 million shares to about 71.0 million shares. Our historical outstanding shares will be recast upon the distribution.

Additionally, the board of directors approved a stock repurchase program authorizing the Company to purchase up to \$50 million of its common stock with available cash on hand.

Furthermore, the board of directors authorized Horizon to purchase two Q400 aircraft in April and June 2012 and sell two Q400 aircraft in the fall of 2012. The expected capital expenditures and aircraft purchase commitments reflect this action.

RESULTS OF OPERATIONS

2011 COMPARED WITH 2010

Our consolidated net income for 2011 was \$244.5 million, or \$6.66 per diluted share, compared to net income of \$251.1 million, or \$6.83 per diluted share, in 2010. Significant items impacting the comparability between the periods are as follows:

Both periods include adjustments to reflect the timing of net unrealized mark-to-market gains or losses related to our fuel hedge positions. For 2011, we recognized net mark-to-market losses of \$30.1 million (\$18.7 million after tax, or \$0.51 per share) compared to losses of \$5.3 million (\$3.3 million after tax, or \$0.09 per share) in 2010.

2011 includes Horizon fleet transition costs of \$38.9 million (\$24.2 million after tax, of \$0.66 per share) compared to \$13.2 million (\$8.2 million, or \$0.22 per share) in 2010.

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:

• 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.

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It is consistent with how we present information in our quarterly earnings press releases;

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 mark-to-market adjustments and other special charges, our adjusted consolidated net income for 2011 was \$287.4 million, or \$7.83 per diluted share, compared to an adjusted consolidated net income of \$262.6 million, or \$7.14 per share, in 2010.

(in millions, except per share amounts)	Years Ended December 31,			
	2011		2010	
	Dollars	Diluted EPS	Dollars	Diluted EPS
Net income and diluted EPS as reported	\$244.5	\$6.66	\$251.1	\$6.83
Fleet transition costs, net of tax	24.2	0.66	8.2	0.22
Mark-to-market fuel hedge adjustments, net of tax	18.7	0.51	3.3	0.09
Net income and diluted EPS, excluding noted items	\$287.4	\$7.83	\$262.6	\$7.14

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OPERATING STATISTICS SUMMARY (unaudited)

Alaska Air Group, Inc.

Below are operating statistics we use to measure operating performance. We often refer to unit revenues and adjusted unit costs, which is a non-GAAP measure. Refer to page 34 on why this measure may be meaningful.

	Twelve Months Ended December 31,					Change	
	2011	2010	Change	2009	Change		
Consolidated Operating Statistics:^(a)							
Revenue passengers (000)	24,790	23,334	6.2	% 22,320	4.5	%	
RPMs (000,000) "traffic"	25,032	22,841	9.6	% 20,811	9.8	%	
ASMs (000,000) "capacity"	29,627	27,736	6.8	% 26,501	4.7	%	
Load factor	84.5	% 82.4	% 2.1 pts	78.5	% 3.9 pts		
Yield	15.78	¢ 15.27	¢ 3.3	% 14.93	¢ 2.3	%	
PRASM	13.33	¢ 12.58	¢ 6.0	% 11.73	¢ 7.2	%	
CASM excluding fuel and fleet transition costs ^(a)	8.55	¢ 8.82	¢ (3.1	)% 9.20	¢ (4.1)%	
Economic fuel cost per gallon ^(b)	\$3.18	\$2.37	34.2	% \$2.05	15.6	%	
Fuel gallons (000,000)	398.3	377.3	5.6	% 365.0	3.4	%	
Average number of full-time equivalent employees	11,840	11,696	1.2	% 12,223	(4.3)%	
Mainline Operating Statistics:							
Revenue passengers (000)	17,810	16,514	7.8	% 15,561	6.1	%	
RPMs (000,000) "traffic"	22,586	20,350	11.0	% 18,362	10.8	%	
ASMs (000,000) "capacity"	26,517	24,434	8.5	% 23,144	5.6	%	
Load factor	85.2	% 83.3	% 1.9 pts	79.3	% 4.0 pts		
Yield	14.06	¢ 13.58	¢ 3.5	% 13.28	¢ 2.3	%	
PRASM	11.98	¢ 11.31	¢ 5.9	% 10.54	¢ 7.3	%	
CASM excluding fuel ^(b)	7.60	¢ 7.85	¢ (3.2	)% 8.26	¢ (5.0)%	
Economic fuel cost per gallon ^(b)	\$3.18	\$2.37	34.2	% \$2.05	15.6	%	
Fuel gallons (000,000)	346.4	319.6	8.4	% 304.9	4.8	%	
Average number of full-time equivalent employees	8,916	8,651	3.1	% 8,915	(3.0)%	
Aircraft utilization	10.5	10.0	5.0	% 9.8	2.0	%	
Average aircraft stage length	1,114	1,085	2.7	% 1,034	4.9	%	
Mainline operating fleet at period-end	117	114	3 a/c	115	(1) a/c		
Regional Operating Statistics:^(c)							
Revenue passengers (000)	6,980	6,820	2.3	% 6,759	0.9	%	
RPMs (000,000) "traffic"	2,446	2,491	(1.8	)% 2,449	1.7	%	
ASMs (000,000) "capacity"	3,110	3,302	(5.8	)% 3,357	(1.6)%	
Load factor	78.6	% 75.4	% 3.2 pts	73.0	% 2.4 pts		
Yield	31.66	¢ 29.11	¢ 8.8	% 27.30	¢ 6.6	%	
PRASM	24.90	¢ 21.96	¢ 13.4	% 19.92	¢ 10.2	%	

^(a) Except for FTEs, data includes information related to regional CPA flying with Horizon, SkyWest and PenAir.

^(b)

See reconciliation of this measure to the most directly related GAAP measure in the "Results of Operations" section.

(c) Data presented includes information related to regional CPAs.

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OPERATING REVENUES

Total operating revenues increased \$485.5 million, or 12.7%, during 2011 compared to the same period in 2010. The changes are summarized in the following table:

(in millions)	Year Ended December 31,		% Change
	2011	2010	
Passenger			
Mainline	\$3,176.2	\$2,763.4	14.9
Regional	774.5	725.2	6.8
Total passenger revenue	\$3,950.7	\$3,488.6	13.2
Freight and mail	108.7	106.2	2.4
Other - net	258.4	237.5	8.8
Total operating revenues	\$4,317.8	\$3,832.3	12.7

Passenger Revenue – Mainline

Mainline passenger revenue for 2011 improved by 14.9% on an 8.5% increase in capacity and a 5.9% increase in passenger revenue per available seat mile (PRASM) compared to 2010. The increase in capacity is driven by the annualization of new routes added in 2010 and new routes in 2011, most of which was Hawaii. The increase in PRASM was driven by a 3.5% rise in ticket yield and a 1.9-point increase in load factor compared to the prior year. The increase in yield is due to raising prices to help offset the 36% increase in raw fuel costs.

Passenger Revenue – Regional

Regional passenger revenue increased by \$49.3 million or 6.8% compared to 2010 on a 13.4% increase in PRASM compared to 2010, despite a 5.8% decline in capacity. The increase in PRASM was driven by an 8.8% increase in ticket yield and a 3.2-point increase in load factor compared to the prior year. The decline in capacity and increase in load factors is due to better matching supply with demand in the regional network.

Freight and Mail

Freight and mail revenue increased \$2.5 million, or 2.4%, primarily due to freight fuel surcharge increases of \$5.4 million offset by lower mail revenue on lower volume.

Other – Net

Other—net revenue increased \$20.9 million, or 8.8%, from 2010. The increase is primarily due to an increase in our Mileage Plan revenues of \$11.6 million with higher commissions driven by a larger number of miles sold to our affinity card partner and a contractual rate increase for those sold miles. Additionally, food and beverages sales increased \$4.3 million due to increased volumes.

OPERATING EXPENSES

Total operating expenses increased \$508.2 million, or 15.1%, compared to 2010 mostly as a result of significantly higher fuel costs. We believe it is useful to summarize operating expenses as follows, which is consistent with the way expenses are reported internally and evaluated by management:

(in millions)	Year Ended December 31,		% Change
	2011	2010	

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Fuel expense	\$1,297.7	\$900.9	44.0
Non-fuel expenses	2,571.2	2,459.8	4.5
Total Operating Expenses	\$3,868.9	\$3,360.7	15.1

Significant operating expense variances from 2010 are more fully described below.

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Wages and Benefits

Wages and benefits increased during 2011 by \$29.6 million, or 3.1%, compared to 2010. The primary components of wages and benefits are shown in the following table:

(in millions)	Year Ended December 31,		
	2011	2010	% Change
Wages	\$703.1	\$674.2	4.3
Pension and defined-contribution retirement benefits	88.3	93.4	(5.5)
Medical benefits	108.1	109.0	(0.8)
Other benefits and payroll taxes	91.0	84.3	7.9
Total wages and benefits	\$990.5	\$960.9	3.1

Wages increased 4.3% on a 1.2% increase in FTEs as a result of increased flying, higher wage rates, and a signing bonus to Alaska's clerical, office and passenger service employees in connection with a new contract ratified in January 2011. Productivity as measured by the number of passengers per FTE increased 5.0% compared to 2010.

The 5.5% decline in pension and other retirement-related benefits is primarily due to a reduction in our defined-benefit pension cost driven by the improved funded status at the end of 2010 as compared to the previous year partially offset by a slight increase in defined-contribution expense.

Medical benefits decreased 0.8% from the prior year primarily due to a decline in employee healthcare claims, partially offset by an increase in post-retirement medical expense.

Other benefits and payroll taxes increased 7.9% from the prior year due to increases in our Workers Compensation and Disability Plan as well as increased payroll taxes in line with increased wages.

We expect wages and benefits to be higher in 2012 compared to 2011 due to higher FTEs to support increases in volume and higher pension expense of approximately \$15 million.

Variable Incentive Pay

Variable incentive pay expense decreased from \$92.0 million in 2010 to \$71.9 million in 2011. The decrease is due to the fact that in 2010 our financial and operational results exceeded targets more so than in 2011.

If we meet targets established under our Performance Based Pay and Operational Performance Rewards programs, variable incentive pay will be approximately \$55 million to \$60 million per year. If we exceed the targets, variable incentive pay will be higher. If we do not achieve targets, it will be lower.

See Note 8 to our consolidated financial statements for additional information.

Aircraft Fuel

Aircraft fuel expense includes both raw fuel expense (as defined below) plus the effect of mark-to-market adjustments to our fuel hedge portfolio included in our consolidated statement of operations as the value of that portfolio increases and decreases. Our aircraft fuel expense is very volatile, even between quarters, because it includes these gains or losses in the value of the underlying instrument as crude oil prices and refining margins increase or decrease. Raw fuel expense is defined as the price that we generally pay at the airport, or the "into-plane" price, including taxes and fees. Raw fuel prices are impacted by world oil prices and refining costs, which can vary by region in the U.S. Raw fuel

expense approximates cash paid to suppliers and does not reflect the effect of our fuel hedges.

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Aircraft fuel expense increased \$396.8 million, or 44.0% compared to 2010. The elements of the change are illustrated in the following table:

(in millions, except per gallon amounts)	Year Ended December 31,		
	2011	2010	% Change
Fuel gallons consumed	398.3	377.3	5.6
Raw price per gallon	\$3.24	\$2.38	36.1
Total raw fuel expense	\$1,289.0	\$898.9	43.4
Net impact on fuel expense from losses arising from fuel-hedging activities	8.7	2.0	NM
Aircraft fuel expense	\$1,297.7	\$900.9	44.0
NM - Not Meaningful			

Fuel gallons consumed increased 5.6%, primarily as a result of a 5% increase in block hours and a slight increase in fuel burn per block hour as a result of higher load factors.

The raw fuel price per gallon increased 36.1% as a result of higher West Coast jet fuel prices. West Coast jet fuel prices are impacted by both the higher price of crude oil, as well as increased refining margins associated with the conversion of crude oil to jet fuel. The average prices of crude oil and refining margins during 2011 were higher by approximately 19% and 141% respectively, as compared to 2010.

We also evaluate economic fuel expense, which we define as raw fuel expense adjusted for the cash we receive from, or pay to, hedge counterparties for hedges that settle during the period, and for the premium expense that we paid for those contracts. A key difference between aircraft fuel expense and economic fuel expense is the timing of gain or loss recognition on our hedge portfolio. When we refer to economic fuel expense, we include gains and losses only when they are realized for those contracts that were settled during the period based on their original contract terms. We believe this is the best measure of the effect that fuel prices are currently having on our business because it most closely approximates the net cash outflow associated with purchasing fuel for our operations. Accordingly, many industry analysts evaluate our results using this measure, and it is the basis for most internal management reporting and incentive pay plans.

Our economic fuel expense is calculated as follows:

(in millions, except per gallon amounts)	Year Ended December 31,		
	2011	2010	% Change
Raw fuel expense	\$1,289.0	\$898.9	43.4
Less net of cash settlement on settled hedges and premium expense recognized	(21.4	) (3.3	) NM
Economic fuel expense	\$1,267.6	\$895.6	41.5
Fuel gallons consumed	398.3	377.3	5.6
Economic fuel cost per gallon	\$3.18	\$2.37	34.2
NM - Not Meaningful			

As noted above, the total net benefit recognized for hedges that settled during the year was \$21.4 million in 2011, compared to a benefit of \$3.3 million in 2010. These amounts represent the cash received net of the premium expense recognized for those hedges.

We currently expect our economic fuel price per gallon to be approximately 18% higher in the first quarter of 2012 due to the rising cost of jet fuel. As both oil prices and refining margins are volatile, we are unable to forecast the full-year cost with any certainty.

Aircraft Maintenance

Aircraft maintenance declined by \$10.9 million, or 5.0%, compared to the prior year primarily due to lower costs associated with the return of leased aircraft and lower costs due to the phaseout of the CRJ fleet, offset by increased airframe check costs and components. We expect aircraft maintenance to be slightly higher in 2012 in line with additional block hours and the timing of scheduled maintenance events.

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Aircraft Rent

Aircraft rent declined \$22.6 million, or 16.3%, compared to the prior-year period primarily due to \$13.7 million less rent related to 11 fewer CRJ 700 aircraft and \$5.5 million less rent related to 5 fewer B737 aircraft leased in 2011 compared to 2010. We currently do not expect any leased aircraft to be returned in 2012, nor do we expect to lease any new aircraft.

Landing Fees and Other Rentals

Landing fees and other rentals increased \$5.4 million, or 2.3%, primarily due to a \$3.6 million increase in facilities rents across our network and a \$1.8 million increase in our landing fee expenses. Mainline landing fee expenses increased due to a 9% increase in departures, partially offset by decreases in our regional departures of 10%. We expect landing fees and other rentals to be higher in 2012 due to increased rates and a slight increase in departures.

Contracted Services

Contracted services increased \$22.1 million, or 13.6%, primarily due to an increase in capacity purchased flying of \$13.2 million compared to the prior year as the new agreement with SkyWest began in May 2011. Additionally, we experienced higher passenger handling of \$2.8 million as a result of an increase in the number of flights to airports where vendors are used and an increase in contract labor of \$2.1 million.

We expect contracted services to be higher in 2012 due to the full year impact of our capacity agreement with SkyWest and the use of contracted labor in Hawaii.

Selling Expenses

Selling expenses increased by \$21.5 million, or 14.0%, compared to 2010 as a result of higher travel agent and ticket distribution costs of \$10.8 million and credit card commissions of \$6.3 million due to increased revenues of 12.7%.

We expect selling expense will be higher in 2012, primarily due to higher revenue-related expenses.

Depreciation and Amortization

Depreciation and amortization increased \$16.4 million, or 7.1%, compared to the prior year. This is primarily due to additional depreciation expense of \$18.0 million for the B737 mainline aircraft, \$6.9 million increase in Q400 aircraft depreciation, offset by a decrease of \$4.0 million in CRJ 700 aircraft and other assets that became fully depreciated or were removed from operation.

We expect depreciation and amortization to be higher in 2012 in line with our six new aircraft deliveries and the annualization of 2011 deliveries.

Food and Beverage Service

Food and beverage costs increased \$9.7 million, or 16.9%, from the prior year due to an increased number of passengers, increase in sales of buy on board products, the higher cost of some of our fresh food items served on board, and increased costs associated with food delivery. We expect food and beverage costs to be higher in 2012 due to increased passenger and departure volume.

Other Operating Expenses

Other operating expenses increased \$34.6 million, or 17.2%, compared to 2010. The increase is primarily driven by higher personnel non-wage costs such as hotels, meals and per diems of \$8.1 million and higher professional service costs of \$7.4 million as well as higher costs for communications, property taxes, passenger remunerations, and deicing. We expect other operating expenses to be higher in 2012 due to higher , property taxes, professional services, IT and training costs.

Fleet Transition and Restructuring Related Expenses

Fleet transition costs increased \$25.7 million, as we finalized our transition to an all Q400 fleet. The increase was directly due to net charges of \$28.3 million related to the removal of the CRJ-700 aircraft and related inventory and a loss on the final disposition of Q200 aircraft of \$10.6 million in 2011.

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Operating Costs per Available Seat Mile (CASM)

Our operating costs per ASM are summarized below:

	Year Ended December 31,		% Change
	2011	2010	
Consolidated:			
Total operating expenses per ASM (CASM)	13.06	¢ 12.12	¢ 7.8
Less the following components:			
Aircraft fuel, including hedging gains and losses	4.38	3.25	34.8
Fleet transition costs	0.13	0.05	NM
CASM, excluding fuel and fleet transition costs	8.55	¢ 8.82	¢ (3.1)
	Year Ended December 31,		% Change
	2011	2010	
Mainline:			
Total mainline operating expenses per ASM (CASM)	11.87	¢ 10.96	¢ 8.3
Less the following components:			
Aircraft fuel, including hedging gains and losses	4.27	3.11	37.3
CASM, excluding fuel	7.60	¢ 7.85	¢ (3.2)
NM - Not Meaningful			

We have listed separately in the above table our fuel costs per ASM and our unit costs, excluding fuel and other noted items. These amounts are included in CASM, but for internal purposes we consistently use unit cost metrics that exclude fuel and certain special items to measure our cost-reduction progress. We believe that such analysis may be important to investors and other readers of these financial statements for the following reasons:

By eliminating fuel expense and certain special items from our unit cost metrics, we believe that we have better visibility into the results of our non-fuel cost-reduction initiatives. Our industry is highly competitive and is characterized by high fixed costs, so even a small reduction in non-fuel operating costs can result in a significant improvement in operating results. In addition, we believe that all domestic carriers are similarly impacted by changes in jet fuel costs over the long run, so it is important for management (and thus investors) to understand the impact of (and trends in) company-specific cost drivers such as labor rates and productivity, airport costs, maintenance costs, etc., which are more controllable by management.

Cost per ASM (CASM) excluding fuel and certain special items is one of the most important measures used by management and by the Air Group Board of Directors in assessing quarterly and annual cost performance.

CASM excluding fuel (and other items as specified in our plan documents) is an important metric for the employee incentive plan that covers all employees.

CASM excluding fuel and certain special items is a measure commonly used by industry analysts, and we believe it is the basis by which they compare our airlines to others in the industry. The measure is also the subject of frequent questions from investors.

Disclosure of the individual impact of certain noted items provides investors the ability to measure and monitor performance both with and without these special items. We believe that disclosing the impact of certain items, such as fleet transition costs, is important because it provides information on significant items that are not necessarily indicative of future performance. Industry analysts and investors consistently measure our performance without these

items for better comparability between periods and among other airlines.

Although we disclose our passenger unit revenues, we do not (nor are we able to) evaluate unit revenues excluding the impact that changes in fuel costs have had on ticket prices. Fuel expense represents a large percentage of our total operating expenses. Fluctuations in fuel prices often drive changes in unit revenues in the mid-to-long term. Although we believe it is useful to evaluate non-fuel unit costs for the reasons noted above, we would caution readers of these financial statements not to place undue reliance on unit costs excluding fuel as a measure or predictor of future profitability because of the significant impact of fuel costs on our business.

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Our current expectations for capacity and operating costs per ASM are summarized below:

	Forecast Q1 2012	Change Y-O-Y	Forecast Full Year 2012	Change Y-O-Y
Consolidated:				
Capacity (ASMs in millions)	7,325 - 7,375	~ 3.5%	31,100 - 31,600	~ 6%
Cost per ASM excluding fuel and special items (cents)	8.87 - 8.92	1	% 8.40 - 8.45	~ (1.5)%
	Forecast Q1 2012	Change Y-O-Y	Forecast Full Year 2012	Change Y-O-Y
Mainline:				
Capacity (ASMs in millions)	6,550 - 6,600	~ 3.5%	27,850 - 28,350	~ 6%
Cost per ASM excluding fuel and special items (cents)	7.90 - 7.95	1% - 1.5%	7.50 - 7.55	~ (1)%

CONSOLIDATED NONOPERATING INCOME (EXPENSE)

Net nonoperating expense was \$55.2 million in 2011 compared to \$65.7 million in 2010. The \$10.5 million decrease is due to lower interest expense due to payments on maturing debt and prepayments of debt in the current year, higher capitalized interest due to higher levels of capital expenditures, offset by lower investment returns in our marketable securities portfolio, and an impairment charge of \$6.2 million on an owned aircraft that was leased to another carrier that filed for bankruptcy protection, and other-than-temporary-impairments on mortgage-backed securities.

CONSOLIDATED INCOME TAX EXPENSE

Our effective income tax rate for 2011 was 37.9%, compared to 38.1% for 2010. The difference between the effective tax rates for both periods and our marginal tax rate of approximately 37.8% is due primarily to miscellaneous non-deductible expenses, such as per diems.

Our effective tax rate can vary significantly between quarters and for the full year, depending on the magnitude of non-deductible expenses in proportion to pretax results.

2010 COMPARED WITH 2009

Our consolidated net income for 2010 was \$251.1 million, or \$6.83 per diluted share, compared to net income of \$121.6 million, or \$3.36 per diluted share, in 2009. Significant items impacting the comparability between the periods are as follows:

Both periods included adjustments to reflect the timing of net unrealized mark-to-market gains or losses related to our fuel hedge positions. For 2010, we recognized net mark-to-market losses of \$5.3 million (\$3.3 million after tax, or \$0.09 per share) compared to gains of \$88.8 million (\$55.2 million after tax, or \$1.53 per share) in 2009.

2010 included Horizon fleet transition costs of \$13.2 million (\$8.2 million after tax, or \$0.22 per share).

2009 included the new Alaska pilot contract transitions costs of \$35.8 million (\$22.3 million after tax, or \$0.62 per share).

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Excluding the mark-to-market adjustments, fleet transition and restructuring costs, our adjusted consolidated net income for 2010 was \$262.6 million, or \$7.14 per diluted share, compared to an adjusted consolidated net income of \$88.7 million, or \$2.45 per share, in 2009.

(in millions, except per share amounts)	Years Ended December 31,			
	2010		2009	
	Dollars	Diluted EPS	Dollars	Diluted EPS
Net income and diluted EPS as reported	\$251.1	\$6.83	\$121.6	\$3.36
Pilot contract transition costs, net of tax	—	—	22.3	0.62
Fleet transition costs, net of tax	8.2	0.22	—	—
Mark-to-market fuel hedge adjustments, net of tax	3.3	0.09	(55.2) (1.53
Net income and diluted EPS, excluding noted items	\$262.6	\$7.14	\$88.7	\$2.45

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OPERATING REVENUES

Total operating revenues increased \$432.5 million, or 12.7%, during 2010 compared to the same period in 2009. The changes are summarized in the following table:

(in millions)	Year Ended December 31,		% Change
	2010	2009	
Passenger			
Mainline	\$2,763.4	\$2,438.8	13.3
Regional	725.2	668.6	8.5
Total passenger revenue	\$3,488.6	\$3,107.4	12.3
Freight and mail	106.2	95.9	10.7
Other - net	237.5	196.5	20.9
Total operating revenues	\$3,832.3	\$3,399.8	12.7

Passenger Revenue – Mainline

Mainline passenger revenue for 2010 improved by 13.3% on a 5.6% increase in capacity and a 7.3% increase in passenger revenue per available seat mile (PRASM) compared to 2009. The increase in PRASM was driven by a 2.3% rise in ticket yield and a 4.0-point increase in load factor compared to the prior year.

Passenger Revenue – Regional

Regional passenger revenue increased by \$56.6 million, or 8.5%, compared to 2009 on a 10.2% increase in PRASM compared to 2009, despite relatively flat capacity. The increase in PRASM was driven by a 6.6% increase in ticket yield and a 2.4-point increase in load factor compared to the prior year.

Freight and Mail

Freight and mail revenue increased \$10.3 million, or 10.7%, primarily as a result of higher volumes and yield and higher security and freight fuel surcharges.

Other – Net

Other—net revenue increased \$41.0 million, or 20.9%, from 2009. The increase is primarily due to Mileage Plan revenues rising by \$31.8 million stemming from a larger number of miles sold to our affinity card partner and a contractual rate increase for those sold miles.

OPERATING EXPENSES

Total operating expenses increased \$228.3 million, or 7.3%, compared to 2009 mostly as a result of significantly higher fuel costs. We believe it is useful to summarize operating expenses as follows, which is consistent with the way expenses are reported internally and evaluated by management:

(in millions)	Year Ended December 31,		% Change
	2010	2009	
Fuel expense	\$900.9	\$658.1	36.9
Non-fuel expenses	2,459.8	2,474.3	(0.6)
Total Operating Expenses	\$3,360.7	\$3,132.4	7.3

Significant operating expense variances from 2009 are more fully described below.

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Wages and Benefits

Wages and benefits decreased during 2010 by \$27.2 million, or 2.8%, compared to 2009. The primary components of wages and benefits are shown in the following table:

(in millions)	Year Ended December 31,		
	2010	2009	% Change
Wages	\$674.2	\$674.6	(0.1)
Pension and defined-contribution retirement benefits	93.4	124.2	(24.8)
Medical benefits	109.0	103.9	4.9
Other benefits and payroll taxes	84.3	85.4	(1.3)
Total wages and benefits	\$960.9	\$988.1	(2.8)

Wages were relatively flat on a reduction in FTE compared to 2009. Wages have not declined in step with the FTE reduction because of the higher wage rates for the pilot group in connection with their new contract effective April 1, 2009 and higher average wages for certain other employees after 2009 and early 2010 furloughs, which are generally seniority-based. However, productivity as measured by the number of passengers per FTE increased 9.2% compared to 2009.

The 24.8% decline in pension and other retirement-related benefits is primarily due to a significant reduction in our defined-benefit pension cost driven by the improved funded status at the end of 2009 as compared to the previous year and the closing of the defined-benefit plans to the new pilot entrants with their new contract in 2009.

Medical benefits increased 4.9% from the prior year primarily as a result of an increase in employee healthcare costs partially offset by a decrease in post-retirement medical expense for the pilot group.

Variable Incentive Pay

Variable incentive pay expense increased from \$76.0 million in 2009 to \$92.0 million in 2010. The increase is primarily due to the fact that in 2010, our financial and operational results exceeded targets established by our Board more so than in 2009. In 2010, additional workgroups were included to the PBP plan, resulting in higher earnings than the profit sharing plan in which they previously participated.

Aircraft Fuel

Aircraft fuel expense increased \$242.8 million, or 36.9%, compared to 2009. The elements of the change are illustrated in the following table:

(in millions, except per gallon amounts)	Year Ended December 31,		
	2010	2009	% Change
Fuel gallons consumed	377.3	365.0	3.4
Raw price per gallon	\$2.38	\$1.88	26.6
Total raw fuel expense	\$898.9	\$686.2	31.0
Net impact on fuel expense from (gains) and losses arising from fuel-hedging activities	2.0	(28.1)	NM
Aircraft fuel expense	\$900.9	\$658.1	36.9
NM - Not Meaningful			

Fuel gallons consumed increased 3.4%, primarily as a result of a 1.1% increase in block hours and an increase in fuel burn due to higher load factors.

The raw fuel price per gallon increased 26.6% as a result of higher West Coast jet fuel prices driven by higher crude oil costs and refining margins.

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Our economic fuel expense is calculated as follows:

(in millions, except per gallon amounts)	Year Ended December 31,		% Change
	2010	2009	
Raw fuel expense	\$898.9	\$686.2	31.0
Plus or minus: net of cash settlement on settled hedges and premium expense recognized	(3.3	) 60.7	NM
Economic fuel expense	\$895.6	\$746.9	19.9
Fuel gallons consumed	377.3	365.0	3.4
Economic fuel cost per gallon	\$2.37	\$2.05	15.6

NM - Not Meaningful

As noted above, the total net benefit recognized for hedges that settled during the period was \$3.3 million in 2010, compared to a loss of \$60.7 million in 2009. These amounts represent the cash received net of the premium expense recognized for those hedges.

Aircraft Maintenance

Aircraft maintenance declined by \$6.6 million, or 3.0%, compared to the prior year period. Mainline maintenance decreased due to less expensive events, lower component costs, and decreased costs associated with aircraft returns, offset by increased engine events in the regional business.

Aircraft Rent

Aircraft rent declined \$14.8 million, or 9.6%, compared to 2009 as a result of the return of three B737-400 and two B737-700 leased aircraft, as well as the removal of five CRJ-700 leased aircraft in 2010.

Landing Fees and Other Rents

Landing fees and other rents increased \$9.6 million, or 4.3%, compared to 2009. The increase is attributable to higher rates in many airports across our network and more departures.

Contracted Services

Contracted services increased \$12.4 million, or 8.2%, compared to the prior year as a result of increased use of vendors across our network, primarily related to our Hawaii network growth.

Selling Expenses

Selling expenses increased by \$22.0 million, or 16.7%, compared to 2009 as a result of higher credit card and travel agent commissions and ticket distribution costs resulting from the increase in passenger revenue.

Depreciation and Amortization

Depreciation and amortization increased \$11.3 million, or 5.2%, compared to the prior year. This is primarily due to four B737-800 aircraft deliveries in 2010 and a full period of depreciation for the ten B737-800 aircraft delivered in 2009.

Food and Beverage Service

Food and beverage costs increased \$7.4 million, or 14.8%, from 2009 due to an increased number of passengers, the higher cost of some of our fresh food items served on board, and increased costs associated with food delivery.

Other Operating Expenses

Other operating expenses declined \$13.2 million, or 6.2%, compared to the prior year. The decline is primarily driven by a reduction in outside professional services costs and lower personnel non-wage costs, partially offset by higher property taxes.

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Fleet Transition and Restructuring Related Expenses

We recorded \$10.3 million in 2010 related to the removal of five CRJ-700 aircraft from our operations under sublease or lease assignment to third-party carriers. We also recorded \$2.9 million of restructuring charges associated with the voluntary separation of a number of employees resulting from the decision to outsource the remaining aircraft heavy maintenance function at Horizon to a third party.

In 2009, fleet transition costs associated with the removal of Q200 aircraft from the operating fleet were \$8.8 million as the final Q200 aircraft were removed from operation.

During 2009, in connection with a new four-year contract, Alaska's pilots received a one-time aggregate bonus of \$20.3 million. We also recorded transition expense associated with establishing the new sick-leave payout program which totaled \$15.5 million, bringing the total pilot contract transition cost to \$35.8 million.

Operating Costs per Available Seat Mile (CASM)

Our operating costs per ASM are summarized below:

	Year Ended December 31,		
	2010	2009	% Change
Consolidated:			
Total operating expenses per ASM (CASM)	12.12	¢ 11.82	¢ 2.5
Less the following components:			
Aircraft fuel, including hedging gains and losses	3.25	2.48	31.0
New pilot contract transition costs	—	0.14	NM
Fleet transition costs	0.05	—	NM
CASM, excluding fuel and noted items	8.82	¢ 9.20	¢ (4.1)
	Year Ended December 31,		
	2010	2009	% Change
Mainline:			
Total mainline operating expenses per ASM (CASM)	10.96	¢ 10.78	¢ 1.7
Less the following components:			
Aircraft fuel, including hedging gains and losses	3.11	2.37	31.2
New pilot contract transition costs	—	0.15	NM
CASM, excluding fuel and noted items	7.85	¢ 8.26	¢ (5.0)
NM - Not Meaningful			

CONSOLIDATED NONOPERATING INCOME (EXPENSE)

Net nonoperating expense was \$65.7 million in 2010 compared to \$64.5 million in 2009. Interest expense increased \$4.0 million primarily due to the write-off of deferred financing costs and prepayment penalties on debt prepaid in 2010, partially offset by lower average interest rates on our variable-rate debt and a lower average debt balance. Other—net nonoperating income (expense) improved by \$7.4 million compared to 2009 primarily due to larger realized gains on the sale of marketable securities.

CONSOLIDATED INCOME TAX EXPENSE

Our consolidated effective income tax rate on pretax income for 2010 was 38.1%, compared to 40.1% for 2009. The difference between the effective tax rates for both periods and our marginal tax rate of approximately 37.9% is due to nondeductible expenses, such as employee per-diem costs and stock-based compensation expense recorded for certain stock awards.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are:

• Our existing cash and marketable securities balance of \$1.1 billion (which represents 26% of trailing 12 months revenue) and our expected cash from operations;

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Aircraft financing – the 31 unencumbered aircraft (as of December 31, 2011) in our operating fleet that could be financed, if necessary;

Our combined \$200 million bank line-of-credit facilities (currently none outstanding);

Other potential sources such as a “forward sale” of mileage credits to our bank partner.

In 2011, we paid off outstanding debt associated with seven aircraft and a portion of the outstanding debt for four additional aircraft totaling \$164.7 million. In addition, we repurchased \$79.5 million of our common stock in 2011 and completed our existing \$50 million Board authorization in January 2012. Finally, we made a voluntary contributions to our defined-benefit pension plans of \$133.3 million in 2011, although there were no funding requirements. We will continue to focus on preserving a strong liquidity position and evaluate our cash needs as conditions change.

We believe that our current cash and marketable securities balance combined with future cash flows from operations and other sources of liquidity will be sufficient to fund our operations for the foreseeable future.

In our cash and marketable securities portfolio, we invest only in securities that meet our overall investment strategy of maintaining and securing investment principal. Our investment portfolio is managed by reputable financial institutions and is continually reviewed to ensure that the investments are aligned with our strategy. As of December 31, 2011, we had a \$12.2 million unrealized gain on our \$1.1 billion cash and marketable securities balance.

The table below presents the major indicators of financial condition and liquidity:

(in millions, except per share and debt-to-capital amounts)	December 31, 2011	December 31, 2010	Change
Cash and marketable securities	\$1,140.9	\$1,208.2	\$(67.3)
Cash and marketable securities as a percentage of trailing twelve months revenue	26	% 32	% (6.0) pts
Long-term debt, net of current portion	1,099.0	1,313.0	(214.0)
Shareholders' equity	1,173.2	1,105.4	67.8
Long-term debt-to-capital assuming aircraft operating leases are capitalized at seven times annualized rent	62%:38%	67%:33%	(5.0) pts

The following discussion summarizes the primary drivers of the increase in our cash and marketable securities balance and our expectation of future cash requirements.

ANALYSIS OF OUR CASH FLOWS

Cash Provided by Operating Activities

During 2011, net cash provided by operating activities was \$696.0 million, compared to \$552.7 million during 2010. The \$143.3 million increase was primarily driven by increased revenues during 2011, higher advanced ticket sales, reduced cash spend on aircraft rent, and increases in miles sold to our Mileage Plan partners, partially offset by higher fuel and non-fuel operating expenses.

We typically generate positive cash flows from operations, and expect to use a portion to invest in capital expenditures.

Cash Used in Investing Activities

Our investing activities are primarily made up of capital expenditures and, to a lesser extent, purchases and sales of marketable securities. Cash used in investing activities was \$403.3 million during 2011, compared to \$295.2 million in 2010. Our capital expenditures were \$387.4 million, or \$202.1 million higher than in 2010 due to eight Q400 aircraft purchases and advance deposits related to our delivery schedule for the next two years.

In addition, we spent \$107.9 million related to the renovation of Terminal 6 at LAX as the project progresses towards completion in the spring of 2012. For financial reporting purposes we are considered the owner of the assets under construction. When we transfer the project to Los Angeles World Airports (LAWA), this asset will remain on our balance sheet

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as we will not qualify for sale accounting due to our continuing involvement with the facility. As of December 31, 2011, we estimate that the total cost of the project will be approximately \$235.0 million, of which \$210 million will be reimbursed by LAWA. Amounts that have currently been reimbursed and future reimbursements will be included in the consolidated statement of cash flows as a financing activity.

We currently expect capital expenditures for 2012 to be as follows (in millions):

	2012
Aircraft-related ^(a)	\$370
Non-aircraft	85
Total Air Group	\$455

^(a) Includes two additional aircraft authorized subsequent to December 31, 2011

The expected increase in capital expenditures from 2011 is due to payments associated with the deliveries of three B737-800 aircraft, three B737-900ER, and advance deposits related to our aircraft delivery schedule discussed later under "Aircraft Purchase Commitments". We preliminarily expect 2013 capital expenditures to be approximately \$360 million.

Cash Used by Financing Activities

Net cash used by financing activities was \$280.0 million during 2011 and \$332.2 million during 2010. During the current year we had scheduled debt payments of \$168.8 million, debt prepayments of \$164.7 million, and stock repurchases of \$79.5 million, offset by the issuance of \$106.5 million debt that was used to pay-off existing debt with higher interest rates.

We plan to meet our capital and operating commitments through internally generated funds from operations and cash and marketable securities on hand, along with additional debt financing if necessary.

Bank Line-of-Credit Facility

The Company has two \$100 million credit facilities. Both facilities have variable interest rates based on LIBOR plus a specified margin. Borrowings on one of the \$100 million facilities, which expires in March 2013, are secured by aircraft. Borrowings on the other \$100 million facility are secured by certain accounts receivable, spare engines, spare parts and ground service equipment. During 2011, we modified the second facility by extending the term from March 2014 to March 2016 and reduced the commitment fee. The Company has no immediate plans to borrow using either of these facilities.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Aircraft Purchase Commitments

Overall, we had firm orders to purchase 27 aircraft, as set forth below. We have options to acquire 42 additional B737s and options to acquire 10 Q400s.

The following table summarizes aircraft purchase commitments by year:

Aircraft	Delivery Period - Firm Orders					Total
	2012	2013	2014	2015	Beyond 2015	
B737-800	3	—	1			