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EDITED TRANSCRIPT

ALK.N - Q4 2021 Alaska Air Group Inc Earnings Call

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OVERVIEW:

Co. reported 2021 revenues of $6.2b. Co. also reported 4Q21 revenues of $1.9b, and 4Q21 GAAP net income of $18m.

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CORPORATE PARTICIPANTS

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

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

Emily Halverson *Alaska Air Group, Inc. - IR*

Joseph A. Sprague *Alaska Air Group, Inc. - President of Horizon Air Industries, Inc.*

Shane R. Tackett *Alaska Air Group, Inc. - CFO & EVP of finance*

Nathaniel Pieper *Alaska Air Group, Inc - SVP of Fleet, Finance and Alliances*

Christopher Michael Berry *Alaska Air Group, Inc - VP Finance and Controller*

CONFERENCE CALL PARTICIPANTS

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

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

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

Conor T. Cunningham *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

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

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

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

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

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

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

Myles Alexander Walton *UBS Investment Bank, Research Division - MD & Senior Analyst*

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

Savanthi Nipunika Prelis-Syth *Raymond James Ltd., Research Division - Research Analyst*

PRESENTATION

Operator

Good morning. My name is Erica, and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group 2021 Fourth Quarter Earnings Release Conference Call.

Today's call is being recorded and will be accessible for future playback at alaskaair.com. (Operator Instructions)

I would now like to turn the call over to Alaska Air Group's Managing Director of Investor Relations, Emily Halverson.

Emily Halverson - *Alaska Air Group, Inc. - IR*

Thank you, operator, and good morning. Thank you for joining us for our fourth quarter 2021 earnings call. This morning, we issued our earnings release, which is available at investor.alaskaair.com.

On today's call, you'll hear updates from Ben, Andrew and Shane. Several others of our management team are also on the line to answer your questions during the Q&A portion of the call.

This morning, Air Group reported fourth quarter GAAP net income of $18 million. Excluding special items and mark-to-market fuel hedge adjustments, Air Group reported adjusted net income of $31 million. Pre-tax margins were 2.4% for the quarter.

As a reminder, our comments today will include forward-looking statements about future performance, which may differ materially from our actual results. Information on risk factors that could affect our business can be found in our SEC filings.

We will also refer to certain non-GAAP financial measures such as adjusted earnings and unit costs, excluding fuel. And as usual, we have provided a reconciliation between the most directly-comparable GAAP and non-GAAP measures in today's earnings release. Over to you, Ben.

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

Thanks, Emily, and good morning, everyone. In 2021, Alaska established a track record of leading the industry in the recovery from the pandemic. This has been enabled by the strength of our business model, our measured approach to capacity and our financial discipline. Our 2.4% pretax margin in the fourth quarter continues that trend, especially considering the disproportionate impact that severe weather had on our hubs, and the Omicron-related impacts we began to face at the end of the year. While I'll discuss the impact of weather on our fourth quarter and the impact of Omicron on our first quarter, let me start by saying, both of these are temporary challenges that do not deter my confidence in our underlying business model and its ability to outperform the industry.

Starting with recent events, the combination of severe snow, multiple consecutive days of sub-freezing temperatures in our Pacific Northwest hubs, and stacking disruptions caused by the Omicron variant, resulted in one of the most challenging holiday travel periods we have ever experienced. Our completion factor was extremely challenged at the end of the year, which resulted in flying approximately 1 point less than our expected capacity in the quarter and 2.5 points less than we planned to operate in December alone. I want to apologize for letting our guests down during one of the most important travel periods of the year, and I also want to acknowledge the strain our teams were under, as everyone worked to stabilize the operation.

In terms of the financial impact of these events, they were material. Our fourth quarter result was worse by approximately $70 million, and our pretax margin was reduced by 3.5 points. Even with this outsized impact, Alaska was profitable in Q4 and strongly led the industry in pretax performance over the second half of 2021.

In response to the ongoing impacts of Omicron in early January, we proactively reduced our remaining Q1 scheduled flying by about 10%. I am pleased to report that Omicron absences are down significantly, and our operation is once again stable.

Omicron has not only impacted our ability to operate fully, it has dampened close-in demand substantially as well. Andrew will provide more detail on the demand environment. But the silver lining is that demand for travel from President's Day and beyond remain strong, and booking trends have rebounded week-over-week since their low point in early January.

We expect the bulk of the Omicron impact to be felt in the first quarter, specifically in January and February, as revenue is reduced and as unit costs are pressured, given lower ASM production and higher staffing-related costs. However, as I opened with, this will be short-term in nature and has not changed our expectations about the overall recovery.

Clearly, this was a tough way to end a year that otherwise had progress worth celebrating. And in that vein, I want to acknowledge that 2021 was a year of significant recovery and highlight some of the important successes from the full year we've just closed out.

First, our revenues recovered to $6.2 billion or 70% of 2019 levels, and we achieved this while flying less capacity than many of our peers who had similar revenue-recovery results.

Second, while the full-year adjusted pretax loss was $342 million, we recorded $282 million of adjusted pretax profit during the second half of the year. Our second half adjusted pretax margin was over 7%, clearly outperforming the industry, even though West Coast travel has recovered slower than much of the country.

Third, with decent demand recovery and disciplined cost management, we returned to positive operating cash flows. Excluding any CARES funding, we generated more than $100 million in operating cash flow for the year, which reflects $100 million pension contribution we funded in the third quarter.

Fourth, as profits and cash flow returned to positive territory, we have essentially repaired our balance sheet. We closed the year with a 49% debt-to-cap ratio, 12 points lower than prior year and within our target range.

And lastly, given we were able to meet or exceed several of our recovery goals, our employees earned the industry's highest bonus pay through our incentive-based pay program. For the average employee, this payout amounts to about 6.2% on top of their annual pay. All told, I'm really pleased to report that our bonus programs will pay out $151 million to our employees for the year.

In addition to these financial milestones, we also cemented several critical strategic decisions during 2021 that will help drive our success well into the future.

We made the decision to return to a single fleet of Boeing aircraft, which will drive revenue and cost benefits. The remaining 27 Airbus A320s that are flying today, will be retired by the end of 2023, enabled by our Boeing MAX order of 93 firm and 52 options.

We joined oneworld and launched our West Coast International Alliance with American Airlines, which will unlock additional revenues and loyalty across our West Coast hubs, especially in Seattle.

We announced sustainability goals, committed to net zero carbon emissions by 2040 and further embracing a sustainability mindset by linking a portion of our annual performance-based pay plan for all employees to the carbon intensity of our operation.

And we renewed our commitment to diversity, equity and inclusion by establishing a 5-year goal to increase leadership representation to match that of our frontline. We also integrated this goal into our executive compensation targets.

Let me close with a brief look ahead at 2022. Like our industry peers, Q1 will clearly be impacted by Omicron, both for revenues and unit costs. We do believe the virus will move to endemic status and that demand will ultimately stabilize. And when it does, our business model is set to outperform.

Notwithstanding a challenging first quarter, we expect to be profitable for the month of March and for the remainder of the year. We remain committed to returning to pre-COVID capacity by the summer and plan to grow from there. I expect full-year capacity to be up versus 2019, between 2% and 6%, dependent on demand. This guidance reflects first-half capacity that is flat, to slightly up and second-half capacity that could be up as much as 10% versus 2019.

As we did throughout 2021, we will continue scaling our business back in a measured way, leveraging our strong balance sheet and running our operation to produce consistent, industry-leading financial performance in 2022.

I hope, you'll join us at our upcoming Investor Day. We plan to share our long-term expectations, including comprehensive 2022 guidance. This event is set for March 24th in New York.

Before I hand it off to Andrew, I want to thank the people of Alaska and Horizon for all that they do. It is no secret that this is a tough business, but the pandemic has surprised and challenged even the most seasoned in our industry. The strength of our company comes from our people and culture of care, our focus on safety and operational excellence, our reputation for customer service and our financial discipline. I am confident these strengths will serve us well again in 2022.

And with that, I'll turn it over to Andrew.

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

Thanks Ben, and good morning, everyone. Fourth quarter revenues totaled $1.9 billion and were only down 15% versus 2019, which was better than our guide. And with flown capacity also down 15%, our fourth quarter unit revenues were flat in 2019.

As Ben mentioned, end-of-quarter weather disruptions were significant, impacting revenue by approximately $45 million. Even with these setbacks, our revenue recovery improved by 3 points from what we viewed was a relatively strong third quarter.

Load factors showed continued improvement throughout the quarter as well, progressing from 75% in October to 80% in November and 83% in December, signaling demand for travel continues to move in the right direction. The strength of this demand clearly played out in our November revenue results. November revenues were down just 7% versus 2019, on 12% less capacity. My take from that result is that our fundamental revenue results were better this November than in 2019, even though we have not seen anywhere close to a full business demand recovery, the full impact of our oneworld and American partnerships, or a complete West Coast recovery. Our network is well positioned for recovery.

Another encouraging indicator are yields, which ended the quarter up 3% versus 2019. This was driven by the strength of holiday bookings and solid demand management by our RM team, despite the Delta and Omicron variants bookending the quarter. For the winter holiday period, we were on pace for flat-to-positive load factors and double-digit yield gains, prior to the impact of the winter disruption. Given all the volatility this year, we achieved great results, and I want to thank my entire commercial organization - they came together as a fully-integrated team and did a tremendous job stimulating demand and welcoming guests back to flying, managing loads and yields and taking care of guests during disruptions. The net result of all of this was posting the best unit revenue performance in the industry for the second half of 2021, at down just 0.5%.

As we've seen all year, guest preference for our first- and premium-class products remained strong in the fourth quarter. First-class-paid load factor ended the quarter up 2 points and premium-class-paid load factor was up 8 points, both versus the fourth quarter of 2019.

Loyalty strength also carried through year end, particularly from our credit card program. Our bank card remuneration reached record levels in the fourth quarter, up 13% versus the fourth quarter of 2019. We have a tremendous partner in Bank of America, who issues our co-brand card, and we're excited about the highly-engaged cardholder base that we've established together.

Looking ahead, while the impact of Omicron will be transitory, each successive variant has been expensive for our business. Post Thanksgiving, we saw a softening of bookings for the first quarter, but most acutely in January. Impacts also bled into February, pre-President's Day, but at a much reduced rate from January. We estimate Q1 bookings lost to this wave to be approximately $160 million. As Ben mentioned, we've seen bookings start to recover from down 40% versus 2019 in the first week of January, to around 25% today. March loads and yields are strong, and we expect them to remain this way as the negative impact of the variant continues to subside.

Given the abrupt softening of close-in demand, we've moderated our capacity plans in the first quarter. We will fly approximately 10% to 13% below the same period in 2019. With the lost bookings in January and February, we expect total revenues in Q1 to be down 14% to 17% from 2019 levels. Q1 is our seasonally-weakest quarter, and while it's unfortunate it will be significantly impacted by Omicron, I'd prefer Q1 was impacted versus any other quarter.

We do anticipate that when Omicron moves behind us, demand will snap back to the recovery path we were seeing leading into the holidays, as that has been the trend after prior waves. Spring and summer travel should be strong on the leisure side, and benefit from the further unlocking of business and international travel. I look forward to quantifying our expectations for the full year, but we're saving many of those details for our upcoming Investor Day.

That said, I do want to speak in a bit more detail about our '22 capacity plans. As Ben shared, we're targeting to return to pre-COVID capacity by the summer and grow through the back-half of the year for full-year 2022 capacity growth of between 2% and 6%, depending on demand.

In Seattle, we are already above pre-COVID capacity. A material portion of our planned growth in the back-half of 2022 will be from our Pacific Northwest hubs, as we look to continue to enhance relevance and scale, mostly through schedule depth.

California demand has recovered more slowly than the rest of the network, but as we bring California fully back in '22, I'm excited about the opportunities that await us. This month we brought on board a new regional Vice President of California, Neil Thwaites, who will be a pivotal part of growing our presence in the state, from both a business and leisure perspective.

From a commercial perspective, I'm anxious to capitalize on a full recovery. I believe, we have the right cost structure, the right commercial offerings and the right balance sheet to allow us to grow versus 2019, as the recovery continues to unfold. We have flexibility to adjust our capacity as needed to match supply with demand, and we are looking at the back-half of 2022 as a period that pivots from capacity recovery to one of capacity growth.

And as we plan for growth across our West Coast hubs, we're eager to maximize the potential of our loyalty program and leverage the international capabilities of our oneworld partners to provide our guests with global access. Beginning summer of 2022, British Airways will fly non-stop service from Portland to London, Heathrow, and Finnair is set to launch non-stop flights from Seattle to Helsinki. This summer, Alaska partners will have over 100 non-stop flights per week off the West Coast to Europe.

We've been navigating the ups and downs of this pandemic for nearly two years now. And while we know the first quarter will be weaker than we expected just a month ago, I'm very optimistic about how we are positioned for March and beyond. And with that, I'll pass it to Shane.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Thanks, Andrew, and good morning, everyone. I'll start, as I always do, with an update on cash flow, liquidity, and our balance sheet. We ended the year with $3.5 billion in total liquidity, inclusive of on-hand cash and undrawn lines of credit, which is essentially unchanged from Q3 and reflects $112 million in debt repayments during the quarter.

Our Q4 cash flow from operations was $129 million, above our previous guidance, largely driven by stronger demand recovery than anticipated, given we were dealing with the now old news Delta variant, as we came into the quarter.

Our balance sheet remains a bright spot and point of differentiation within the industry. This year, our debt-to-cap fell to 49%, 12 points below year-end 2020, placing us within our stated target range and as Ben said, essentially back to our pre-COVID balance sheet strength. In fact, in a period marked by increasing debt across the industry, our adjusted net debt ended the year 40% lower than 2019. We're pleased to have received a credit upgrade in late December as well, moving us one step closer to an investment-grade rating.

The weighted average effective rate of our outstanding debt is 3.3% and our debt service is entirely manageable going forward. Contractual debt repayments in 2022, are about $370 million, with $170 million in Q1. Given the low-cost nature of our debt, we don't plan to make any significant prepayments during 2022. Rounding out the strength of our balance sheet, our pension plans ended the year at 98% funded, the highest level we've achieved since 2013.

Our strong balance sheet and ample liquidity put us in a terrific position to pay cash for the 32 737-9 aircraft deliveries we have in 2022. We feel very comfortable with our liquidity position, especially given our belief that we are back to annual profitability and consistent annual positive cash flow generation. By the end of 2022, I expect our total liquidity will step down to around $2.5 billion, and our net debt-to-EBITDAR to settle around 2x or less.

Turning to the P&L, our 2.4% pretax profit was a solid outcome given the circumstances in the quarter. Andrew spoke to the revenue results, and I'll dive into our costs. Our non-fuel costs were $1.4 billion in the fourth quarter, inclusive of approximately $25 million of unexpected costs from the December disruption. This was driven by approximately $18 million for overtime and wage premiums, as we worked to stabilize the operation from staffing disruptions, and $7 million incurred for passenger remuneration, de-icing, and other related costs.

A typical bad weather event for Alaska might last a couple of days and impact a single hub. The December event lasted an entire week, impacted both Seattle and Portland and was exacerbated by the start of a surge in Omicron-related staffing shortages. In short, a literal perfect storm. As Andrew indicated, the revenue impact of our cancellations was $45 million. And given the $25 million in incremental cost, this event alone raised $70 million of profit from the December month and quarter. The combination of lower ASM production and higher costs, resulted in our CASMex being up 12% versus 2019, outside the high end of our range. Absent the disruption, our cost results would have been in line with our guide.

Looking ahead on costs, our commitment to returning to 2019 CASMex levels remains unchanged. We know we've got our work cut out for us. Our business model thrives on predictability and execution, and it is obvious that COVID has inserted a level of volatility into our industry that makes managing a high fixed-cost business more difficult.

2022 will start off very challenged, but we fully expect it to sequentially improve materially as the year progresses. For the first quarter, Q1 CASMex is expected to be up 15% to 18% and capacity down 10% to 13% versus 2019.

7 points of this is purely driven by our late pull down of first quarter capacity. While the reduction will help ensure our ability to operate the flights we sell, given Omicron's impact on staffing, and is a hedge against lower close-in demand, the reality is, we cannot pull out most costs this close in. Absent the capacity pull down, our unit cost guide would have been up 8% to 11%.

In addition, our costs in Q1 include two items contributing another 3.5 points of pressure that are worth detailing. First, approximately 2.5 points of our Q1 unit cost increase is related to lease return expenses for our Airbus aircraft.

As previously noted, given the speed with which we plan to return to a single fleet, we will be incurring significant costs associated with returning these leased Airbus aircraft, primarily over the next 2 years. I currently expect the total lease return expense to be between $200 million and $275 million in total, with more than half of that being recorded this year. These transitory return costs begin in earnest in the first quarter of 2022, will peak by Q4 of this year and will then taper through 2023, as the last A320 leaves the fleet. So while a headwind right now, it will become a tailwind to our cost structure in the next 8 quarters, which will be further helped as we replace the 150-seat Airbus with the 178-seat, more cost-efficient Boeing 737-9 aircraft.

Second, approximately one point of our expected Q1 unit costs are being driven by incremental training costs and wages of newly-hired employees as we prepare to recover to pre-COVID capacity by the summer. To move from 80% to 85% of pre-COVID flying to 100% and then beyond, we must staff up early, given the throughput capacity of our hiring and training infrastructure.

We expect fuel prices to be between $2.45 and $2.50 per gallon in Q1, also increased from the last quarter. Despite this quarter's cost guide, largely driven by the late pull down of capacity that I noted, we expect significant sequential improvement in unit costs as we recover capacity throughout the year. We expect full-year 2022 unit costs inclusive of lease return expense, to be up 3% to 6%, and on an ex-lease return basis, to be up 1% to 3%. This estimate implies returning to our pre-COVID cost structure during the second half of the year.

This entire pandemic and our recovery has been obviously unpredictable, but I'm excited about what lies ahead for Alaska. I truly believe we've set up our business to deliver superb results as demand fully stabilizes. With continued focus on our cost initiatives, fleet transition and our commercial opportunities, we have valuable levers that set us up for a great next couple of years. And with that, let's go to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first caller is Duane Pfennigwerth of Evercore ISI.

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

I wanted to ask you, kind of, an industry revenue management question, and I think it's a little tricky to answer here in January, but I'll give it a shot, nevertheless.

So as we have these waves, these recurring waves, probably the first time we saw one of these waves, the industry's willingness to, sort of, hold back on the future and hold back on inventory management into the summer, et cetera, was probably pretty limited.

I wondered, if you could contrast, maybe, the second wave with this period of time? And to what extent, have we already sold forward, kind of, summer yields at less-than-optimal levels?

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

Yes. That's actually a really, really interesting question. I think, if you looked at our third quarter performance, it evidenced very, very strong demand. November and December, again, evidenced very, very strong demand. With each of these waves, it's about 4 weeks from the peak of the negative bookings, down to a recovery in the mid-teens.

And specifically to your question, from a revenue management perspective, we don't think it's much of a pricing issue as it is volume. And so that's why we've returned really good yields. We've been holding out for that excess demand and that strong demand when it comes.

Even as of March and beyond, we're sitting in a very good yield and unit revenue position. So from our perspective, the demand is the problem with the waves, but when the waves go, the demand comes back. And when we see that, we manage the revenue accordingly.

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

And then maybe just sticking with revenue. Is there anything you'd call out regionally, as we think about the rest of this year and again into the summer? Can you remind us what was better, what was worse? And any commentary you might have on Hawaii, specifically.

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

Yes. We don't really talk a lot about regions per se. The thing that our team has done a really good job, is really managing the capacity in those regions. And you'll see, as we've shared in our prepared remarks, California was in a weaker position, and we have most of the capacity coming out of there, where we're stronger, we have more capacity coming back.

I think, Hawaii has been doing quite well. I think, we've got past the issues with vaccination and all the rest of it and guests are flying. Our loads are a little lower than pre-pandemic, but overall, the business is performing.

Operator

Our next caller is Hunter Keay of Wolfe Research.

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

Andrew, have you ever -- or Ben, have you ever thought about using price to manage costs, in the sense that we've got these -- you just mentioned, you're always willing to push for yield a little bit, and we have these really peaky periods, where the operation just gets so stressed with volume.

Have you thought about pushing yields a little harder, maybe to save yourself some IRROP or cost risk or maybe you lose a point of load factor, but you save 1.5 points of CASM because you're intentionally keeping volumes down at peak periods?

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

Maybe I'll start, Hunter, it's an interesting thought. I think, honestly, we've sort of built our brand on being value for money. And so we have fare caps, just to be frank. We will get to a point, where we will not charge guests any more than certain amounts.

And so we're very much focused that when our guests come to book, that they feel like they're getting good value for money. And so to take that approach, would probably breach some of our concepts there. That's just my thoughts on that.

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

Here's another interesting question for you. Have you seen the weakness in tech stocks, every day, impact your bookings?

I mean, a lot of your passengers are Seattle based, they have tech stocks in their personal portfolios. And I've always thought that the day the market is down, people don't book airfare, I would imagine that's particularly key with you guys being in the Pacific Northwest.

So have you ever given any thought, Andrew, to tying your daily bookings with what you're seeing in the market, specifically, as it relates to the weakness in tech stocks this year?

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

You know, Hunter, you've hit on, obviously, a very key point. And I just -- our business got back to 50% in December. I'm just going to say, the largest tech companies, their travel is anywhere down from 70% to 90%, right now. They are not traveling. And that impacts the volumes in those high-tech markets. As far as general demand, as I said earlier, I don't see a willingness to pay really being the issue. It's just volumes really being the challenge.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Andrew is just giving you, sort of business traffic. I think on the leisure side, people who work at tech companies are still traveling if that's your question. We haven't seen a pullback in that based on that.

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

Yes. That's not exactly the question, Shane, but regardless, I appreciate the color.

Operator

Your next caller is Dan McKenzie of Seaport Global.

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

Just going back to that last comment, it seems that December yields were up double digits, if I heard that correct, and that's really without a lot of your corporate travel.

I'm just wondering, if you could elaborate a little bit more on pent-up demand, the script was helpful. But does it feel different this time versus past downturns? And if so, what's driving that?

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

Yes. I think -- one thing that's a little different is, first quarter doesn't -- other than starting in March, does not have, sort of, the peak bookings that, sort of -- when you came off the Delta variant, you had in November and December.

So again, I think the yield environment, from where I sit, is very good, quite frankly. And I fully expect Omicron, as we get this behind us, we're going to start to see the spring and beyond bookings come back to life.

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

Okay. And Andrew, you've digested a lot of growth over the years. You've done a great job with it. Does the growth, later this year, skew towards long, medium or short haul flying?

And if you're exiting the second half of the year at double-digit growth, does 2023 -- should we think about that trending closer to the historical 4% to 6% or 4% to 8% growth rate? Or are there anomalies that we need to keep in mind, as we kind of build out through next year?

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

Yes. I think, as it relates to capacity, we -- what we're planning to grow in the second half of the year, we've grown a number of times at those rates, maybe 2015 and '16, for sure. So we feel really good about that.

I think, I can't really comment on 2023. But again, our goal was to get California back pre-COVID levels. And then in the back half, continue to grow and fill in the depth of our schedule in the Pacific Northwest, and that's, sort of, what we plan to do.

Operator

Your next caller is Savi Syth of Raymond James.

Savanthi Nipunika Prelis-Syth - *Raymond James Ltd., Research Division - Research Analyst*

Just on the -- I was wondering, if you could provide a view on CapEx for 2022 and 2023? And any other kind of notable demands on cash this year and next year other than kind of the debt color that you provided?

Nathaniel Pieper - *Alaska Air Group, Inc - SVP of Fleet, Finance and Alliances*

Savi, it's Nat Pieper. Thanks for the question. CapEx for '22, looking at about $1.6 billion, and we've been open, as Ben referenced in the script, really taking the decision to go single fleet and over-index with Boeing on deliveries, over the next couple of years, as we phase out A319s, 320s and get the most efficient airplanes in the sky that we can.

From a debt obligation perspective, we don't have, as Shane referenced, a lot of expensive obligations coming. We've got about $450 million principal, plus interest over the year, which frankly, given our cash balance, given where our debt ratios sit, we should be able to stomach that very, very easily.

Savanthi Nipunika Prelis-Syth - *Raymond James Ltd., Research Division - Research Analyst*

Makes sense. So a couple of years of, kind of, elevated CapEx here, at least, is fair.

Nathaniel Pieper - *Alaska Air Group, Inc - SVP of Fleet, Finance and Alliances*

Yes. And as we've said, with 2023, again, a number of airplanes coming.

Savanthi Nipunika Prelis-Syth - *Raymond James Ltd., Research Division - Research Analyst*

Okay. That makes sense. And then, I know the regional operation is not a big part of your, kind of, overall capacity. But just curious, how that is impacting your 2020 outlook as Horizon and your partners, kind of, deal with pilot supply issues and now more recently, this kind of whole fee ban rollout issue?

Joseph A. Sprague - *Alaska Air Group, Inc. - President of Horizon Air Industries, Inc.*

Savi, it's Joe from Horizon. Yes, pilot attrition is definitely a reality in the regional industry, right now. Horizon has seen a fair bit of it over the past quarter. The attrition that we're seeing, I would say, has, so far, been right in line with our projections, though.

So the adjustments that we made to our flying for this year, so that we can, sort of, get folks hired up to replace those that are departing and account for the training cycle, that's baked into our plan and is proceeding, as it has sort of been sketched out last fall.

We have not dropped any cities, and the amount of reduction in our flying has been pretty much in line with other regionals. 5G is definitely a little bit of an impact. We do operate the E175, and we're working through that with the FAA and hopefully will get a resolution on that soon.

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

And Savi, I might just add that regionals in total is around 10% of our capacity. And really, all of this growth is coming from gauge and stage, and Max and retirement of Airbus, and mainline growth. That's really what's driving what we see in 2022.

Operator

Your next caller is Conor Cunningham of MKM Partners.

Conor T. Cunningham - *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

Maybe a follow-up to Savi's question. Just again, when we think about the hiring issues, it's always about the regionals, the one that people are most concerned about, your MAX order, right now, is under the larger variant.

But has there ever been any thought to actually replacing or maybe upgauging the regional effort to a smaller MAX, just because it's probably easier to hire at the mainline, going forward, than it is at horizon?

I realize that there's a big jump in capacity. But some of those markets seem like they may be able to support a larger plane now.

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

Thanks for the question. I think, when we look at the fleet structure, I like where we are. I mean, we serve small Pacific Northwest markets that are just suitable for our airplanes.

So we like the fleet mix. When you look at 737 MAX, whether you're looking at -7, -8 or -9, we skew towards the larger airplanes, in terms of unit cost per seat. So I pretty much like where we are, and I think we're going to continue on that path.

Conor T. Cunningham - *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

Okay. Great. You guys get unique questions because you're a unique airline that made money in the second half, last year. So the -- maybe just on the second-half capacity ramp. So just trying to reconcile everything. You talked a little bit about it, but potentially going to be 10% larger, or double digits, I guess, is what you said.

And I was a little surprised by that. I mean, I think your fleet is only 5% larger. So I realize that there's some stage and gauge, maybe you can quantify what that is. But is your utilization potentially going to be higher in 2022 -- in the second half of 2022 versus 2019? I'm just trying to, again, reconcile all the moving parts there.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

You got all 3 of the factors. There's some stage length growth. There's certainly some seat gauge growth, given the larger MAX -9 aircraft and then there's utilization that we can press the fleet a little bit harder on than we are right now.

Conor T. Cunningham - *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

Do you care to share the moving parts? Or is that a later date?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Actually, stage is one of the larger drivers, probably half of that difference. And then the other 2 are probably similar in terms of sizing.

Operator

Your next caller is Ravi Shanker of Morgan Stanley.

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

If I can ask the first question, but from the cost side, on the revenue side, has everything that's happened in the last 3 to 6 months with Omicron and Delta and everything else, fundamentally changed the way you think of staffing and resourcing the airline, going forward?

Or do you feel like this is pretty much an idiosyncratic pandemic-driven issue, and once we get back to normal, it should be kind of going back to normal, service resumes -- just operational efficiency?

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

Ravi, it's Ben. I think, being under this COVID umbrella, I think there is a different mindset, in terms of staffing, there is a little more sliding towards overstaffing, just to take care of people who get sick, this is an infection that goes through people rather quickly with Omicron.

But if you look long term, our plan is to get back to productivity levels back to what we had pre-pandemic. So we're in a COVID phase, right now, and we have to stop appropriately for that, which will be a little higher than we normally be, but our goal is to get back to pre-pandemic levels.

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

Understood. And for my follow-up, not to steal the thunder from your Analyst Day, but on the last call, you guys hinted at the potential of returning to the cash return by the end of this year. And clearly, you guys are flexing your muscle on the balance sheet. Any updated thoughts on that at this point?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Ravi, it's Shane. No. I think, what we've said is, number one, our philosophy hasn't changed, so shareholder returns are part of our long-term capital allocation philosophy.

And number two, we wanted to be in a position, sort of, before others to make a decision to go back into shareholder returns, but it's not an active discussion, we're precluded from doing it, as you know, until the end of the year. So sometime, over the first of the year, we'll start talking about it with our Board. And certainly, once we know something, we will share it with you all.

Operator

Your next caller is Andrew Didora of Bank of America.

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

First question for Shane, and there's a question I'm asking a lot of the airlines, this earnings season. But can you maybe talk to, sort of, the wage inflation that you're considering for your labor groups, when you kind of model out your 2022 cost plan?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. Andrew, I'll take this in two parts. The first is, we noted, last call, some entry-level wage pressure, and we've had to move wages for a few of our groups, just in order to attract folks in the tight labor market. We had priced that at about $7 million for the quarter. That remains in the business today, and it may end up being permanent, I'm not sure, and we'll see how labor market unfolds.

Our cost guides don't typically include new CBA costs. And so that's just been our standard for many years. I think it's worked well and so right now, those don't include changes to CBAs. And we'll be in negotiations with several of our groups, over the course of the year.

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

Got it. And is that $7 million pretty standard across each of the quarters, so talking about maybe a $30 million wage rate headwind?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes.

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

That's fair. Okay. And then, Shane, also you had a decent hedge gain in the quarter. What's your hedge position like today? And I guess, more importantly, how are you thinking about the program today, given kind of the continued mismatch between the revenue recovery and where fuel is going?

Nathaniel Pieper - *Alaska Air Group, Inc - SVP of Fleet, Finance and Alliances*

It's Nat, I'll take this one. So our current hedge position -- we've had an established program since 2015, where we hedge 50% of expected gallons with call options, 20% out of the money. And for 2022, we're currently 42% hedged at $72, so a decent position on that and projecting right now for '22, similar sort of return, as we saw in 2021, and obviously very volatile markets.

I think that program works well for us. We had internal debate on it, we frequently do. But it's just consistent with what Alaska has done financially of being stable, conservative and just sticking to the program and not being overwhelmed with reactionary actions, when fuel spikes or when fuel drops.

Operator

Your next caller is Jamie Baker of JPMorgan.

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

I'll start with the yield question, but I'll try to make it interesting. I think, it was the April call last year, when I asked about the steepening booking curve for leisure and the potential for strong summer yields.

I'm just wondering if we should be contemplating the opposite now? So as demand recovers, that's a good thing, but as consumers increasingly, have the confidence to book further out, is it inevitable that you see some yield erosion in that scenario?

Or is there some optimism that you can hold on to some of the yield benefits that presumably accompany a steeper curve?

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

Yes. It's -- this is something that you look at every week to make sure you understand the changing dynamics. I think, all I can share with you is where we are today as the reference point. As we look at the current bookings and the reductions in bookings because of the Omicron variant, we're seeing the highest level or the highest reduction closer in.

Obviously, business is a part of that but also leisure. As you move out to 2 months away, 3 months away, and in fact, 4-plus months away, 4-plus months bookings, although smaller on an absolute scale, are actually in the best position.

So what we're seeing, right now, is good booking progression in the outer years. And as we look at our network today, as we look at our demand, we don't hit really big decision points on the question you're asking, for another few months, to sum up, for sure. And we feel pretty good, right now, and we're just holding out for summer that is as good as 2019 or maybe even better.

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

Okay. That's helpful. And then for Ben, sort of a high-level question, but when you think about your 2022 guide or outlook, rather, what you're looking at, not necessarily what you're sharing with us, what do you think are the 2 or 3 most idiosyncratic components that are unique to Alaska?

I mean, rising demand tide, fuel, labor challenges, that's all industry stuff. I want to hear what you think is most unique to you or rather Alaska, preferably in rank order?

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

Right. That's a great question, Jamie. Let me give it a shot here in 30 seconds. One, like I have just tremendous confidence in our business model. And if you look how we're positioned in the Pacific Northwest and on the West Coast, what really excites me is the West Coast coming back to life, out of this pandemic and getting our network back to 100% of pre-COVID levels. So that is priority #1 for me, is getting back to 2019.

And second is setting the stage for growth in the back half of the year. So those are two big things that I think about. And I think, there's a lot of potential on the West Coast, particularly in California, where it's just -- it's ramped up a little slower than the rest of the country, but I think there's a lot of potential there.

Those are two big things, and third, I think, as international travel comes back, the one thing I'm really excited about in here, we've sown the seeds with oneworld, is seeing international traffic come back in our West Coast hub, particularly in Seattle, where we give global access to our guests, and I think you'll see accretive revenue to Alaska with that.

Operator

Your next caller is Helane Becker of Cowen & Company.

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

I noticed that you pulled down capacity out of Paine field. Could you just talk about what the plans are for that, I guess, for Paine, going forward?

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

Paine, we've obviously -- 5G has been a massive issue for Paine field, just to be frank. So that's why that's struggling right now. But if you look out into the schedule, we're going to get back to our 18 departures a day, full-slot complement, sort of, by the summer/fall.

So it's just a matter of ramping that up and digesting what Joe has talked about a little bit because it's all regional up there. We are going to put some mainline in there, but just getting the regional fleet to a place where we can serve that at full capacity.

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

We have 12 departures a day now, going to 18 departures by the summer.

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

Okay. That's helpful. And then my other follow-up question also has to do with the network. During the pandemic, you restructured the network to be more focused on the Pacific Northwest and North South, especially California.

As you think about ramping back, how should we think about getting back to some of the transcon flying you were doing pre-pandemic that might make sense to go back to, going forward? And then just as a part of that, do you have an actual number for how many people you're intending to hire this year?

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

Maybe I'll start with the first one, Helane. Our network, obviously, we have slots in New York. But if you look forward at our booking schedule in April and May and beyond, you're going to see what our network looks like.

The reality is -- I think we've announced two of them, really, you're going to see very, very, very few new markets from Alaska Airlines. It's just returning schedule depth. And that's what's really going to happen. And so especially with California, you're going to see the return of schedule depth.

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

And Helane, we're going to hire about 3,000 people in 2022.

Operator

Your next caller is Catherine O'Brien of Goldman Sachs.

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

I have a couple on the cost outlook. I know, the full year outlook is negatively impacted by IRROPs from 1Q. You've previously said that on slightly less than '19 capacity, to be below '19 CASMex. That was a while ago now, a lot of stuff has changed.

But I guess, should we still expect that to be true, as the operation normalizes into 2023, just with less training, restart cost? Or has inflation just changed that? I know, it's a little wonky to compare, since you actually be growing versus '19. Just any color there would be great.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Catie, I appreciate the question, and yes, a couple of things: Number one, we are intending to grow now. So it's a little bit of a different dynamic. And when we were talking about that, and we're still very committed to getting back to pre-COVID cost structure.

I think, our underlying assumption or sort of fear, at the time, was that this might be a very long recovery cycle and that demand may be depressed for a longer period of time.

And I think, what we believe is that there's a lot of demand. It's just not able to be fully actualized until these waves go away and we normalize society, and I think, the economy remains healthy. I know there's inflation worries and stuff like that, but it didn't have that dampening effect on the economy and demand that we may have originally feared, when this all immediately took root.

So I think, what you should know about us, and I know you do, is cost management and cost discipline is part of our DNA. We know it's the only, sort of, way we can create stability for our people and for investors long term, and we are going to ultimately head back towards pre-COVID efficiency and productivity and cost levels.

But it is a different setup that we're dealing with, today, and we're looking at a growth scenario, not sort of a shrink scenario.

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

Got it. So maybe just a follow-up to that. I don't want to put words in your mouth, Shane, but maybe this year, more heavily impacted by some of these incremental training, kind of like start-up or restart costs, I guess, you could call it, than you might have thought, which -- hits CASM, but is ultimately a good thing, if demand is going back faster. Is that -- do I have that right?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Absolutely right. Plus, I think, had we not decided to go single fleet, we would have had these lease return costs spread out over a much longer period of time. So there's an acute sort of impact from that, this year as well. So I think, those are two of the biggest drivers.

To the degree that inflation runs through the industry, I mean, it's going to hit everybody, and so we're not assuming that, that's going to be a major obstacle for us, for a long period of time. It hasn't, I think, been a major obstacle for us. It's more about ramping for growth in some of these transitory costs we've got to go through, to a single fleet.

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

Okay. Got it. And lease returns are happening on a bit of a faster pace than when you first said that, too, right?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. We really didn't have a mindset around the fleet. We had spent, I think, 3 years talking to you all about needing to make a fleet decision, the pandemic, sort of, gave us an opportunity to actually sit down and make one. And we were happy that we had to be forced to make one.

It's hard to do a fleet transition pre-COVID, when you're trying to grow and the whole economy and industry are growing, it's hard to think about taking some of that growth away.

And so this has given us a chance to move through that fleet transition, pretty quickly. Even though 2 years feels long, it's actually a pretty quick time period to get 60 to 70 units out the door.

Operator

Your next caller is Brandon Oglenski of Barclays.

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

I guess, a real quick follow-up on that. And maybe I've just missed it in the last few months. But have you guys made an announcement as well on the A321s then?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

No. Brandon, we haven't. No, we have not. I think, they're leased through 2030, essentially. We don't -- in a perfect world, we wouldn't hold them that long. We haven't really started working on dispositioning those.

But I wouldn't be shocked, if we held them for a while, and I wouldn't be shocked, if we were able to find a place for them to go.

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

Okay. I appreciate that. I just want to make sure I wasn't missing it. And then I guess, maybe this question is for Ben, but I'm not sure. As you look out, you said you could even be growing maybe 10% by the end of the year, I think, if I heard you correctly, to what level of profitability do you hold those thresholds?

Because obviously, you're baking in a lot of costs, right now, to restore the network, just as a lot of your competitors are, too.

Is this a game, where -- not a game, but do investors just have to wait for everyone to get back to full restoration of capacity, before we can start talking about restoration of profitability?

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

Brandon, it's a great question. I think, if you look at our track record, if you look at our second half of '21, with everything that's been thrown at us, we generated a 7% pretax margin, and we were the most profitable airline in the industry.

So our mindset is always to grow profitably. We don't grow without believing that we can grow profitably. So that's our mindset. That's the plan, going forward, and that's how we plan to execute.

Operator

Your next caller is Mike Linenberg of Deutsche Bank.

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

Just, sort of, two quick ones here. Andrew, we've obviously seen some correlation between case counts and bookings. And I'm curious, case counts have just collapsed on the East Coast.

And yet, I think, out west, like State of Washington, State of Alaska, as I last checked, they're still asymptotic.

Are you seeing point-of-sale differences for your -- particularly in your transcon flights, where you're getting stronger bookings, maybe east of the Mississippi versus West? Any color there?

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

Mike, it's a little hard to answer that question. I think, the vast majority of our network is really anchored on the West Coast, and given slots and everything, we're probably bringing back capacity a little bit quicker than we'd like, on the transcon.

You nailed it on the case counts, and I celebrate New York City every day with counts coming down. We normally lag a few weeks behind that, and I think, we've sort of peaked, and we're going to start to come down. And I think, you're going to see the same behavior you do there on the East Coast as you do here, as it relates to bookings.

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

Okay. That's great. And then just second, just a quick one here. You gave us, kind of, the increase in your Loyalty program remuneration in the fourth quarter.

Can you give us a rough number of what that is, on an annual basis? I know, some of your competitors will provide that number. Anything rough, what you're bringing in on that Bank of America card deal?

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

Yes. I think, I don't know the exact number, but I think this was our first year, where we generated over $1 billion, just, I think, $1.1 billion from our card program this year, which is higher than it's ever been before in the pandemic. So we feel very, very good about that.

Christopher Michael Berry - *Alaska Air Group, Inc - VP Finance and Controller*

It -- this is Chris, and it is the highest it's ever been. It was -- year-over-2-year, it was definitely about 5% or 6% higher than it had been in 2019. So it was a remarkable year, from that respect.

Operator

Your next caller is Myles Walton of UBS.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

I think, Ben, from your comments, you were implying the first half was going to be about flat with 2019, obviously implies a pretty big step in the second quarter. I think, the largest sequential growth in ASMs you've had since the pandemic and restoration.

Can you just talk about the risks in achieving that objective? I know, you're putting costs in, and you're putting the training in now, but is that sort of the trajectory you're looking for?

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

Yes. Myles, we -- getting back to pre-COVID capacity, was always on our radar from 18 months ago, just to be honest. And so we've been planning towards that, the hiring, the infrastructure, the training - so we're on a good path.

The pipeline for hiring is full, but it is a competitive market. It's a tight labor market, and we've got to fight for good employees and that's always a risk, but it's a risk everybody has.

In the second half, the same thing. We have set up our whole leadership team and is really poised on executing growth. That's been our plan for the last 12 months, and of course, there are risk factors that everyone is facing, but we feel good about where we are right now.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

Okay. And your first quarter implies only a 300 to 400 basis point difference in the capacity versus 2019 and revenue versus 2019. Is that a fair way to think about the remainder of the year? Or do you think there'll be a little bit more unit revenue pressure, as the capacity comes back with speed?

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

Sorry, I didn't quite track your question, I apologize.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

Sure. Yes, the capacity restoration versus the revenue restoration versus 2019, is only about a 400 basis point difference. Do you think that closes or expands, as you move through the rest of the year?

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

I'm probably not going to sit here today to answer that question, but I will say that as Ben shared, we plan to grow profitably, and so we don't grow if there's no demand, and we're not able to turn that growth into something that's profitable. So that's where we're at.

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

Thanks for joining us for our fourth quarter call, and we look forward to talking to you guys soon at Investor Day. Thank you so much.

Operator

Thank you for participating in today's conference call. This call will be available for future playback at alaskaair.com. You may now disconnect.
