

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2019

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 1-8957

ALASKA AIR GROUP, INC.

Delaware
(State of Incorporation)

91-1292054
(I.R.S. Employer Identification No.)

**19300 International Boulevard, Seattle, Washington 98188
Telephone: (206) 392-5040**

| Title of each class | Securities registered pursuant to section 12(b) of the Act: | Ticker symbol |
|--------------------------------|---|----------------------|
| Common Stock, \$0.01 Par Value | Name of exchange on which registered New York Stock Exchange | ALK |
| | 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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:

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2020, shares of common stock outstanding totaled 122,913,010. The aggregate market value of the shares of common stock of Alaska Air Group, Inc. held by nonaffiliates on June 30, 2019, was approximately \$7.9 billion (based on the closing price of \$63.91 per share on the New York Stock Exchange on that date).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Definitive Proxy Statement relating to 2020 Annual Meeting of Shareholders are incorporated by reference in Part III.

ALASKA AIR GROUP, INC.
ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2019

TABLE OF CONTENTS

| | | |
|-----------------|--|-----------|
| <u>PART I</u> | | <u>4</u> |
| <u>ITEM 1.</u> | <u>OUR BUSINESS</u> | <u>4</u> |
| <u>ITEM 1A.</u> | <u>RISK FACTORS</u> | <u>19</u> |
| <u>ITEM 1B.</u> | <u>UNRESOLVED STAFF COMMENTS</u> | <u>26</u> |
| <u>ITEM 2.</u> | <u>PROPERTIES</u> | <u>26</u> |
| <u>ITEM 3.</u> | <u>LEGAL PROCEEDINGS</u> | <u>27</u> |
| <u>ITEM 4.</u> | <u>MINE SAFETY DISCLOSURES</u> | <u>27</u> |
| <u>PART II</u> | | <u>27</u> |
| <u>ITEM 5.</u> | <u>MARKET FOR THE REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES</u> | <u>27</u> |
| <u>ITEM 6.</u> | <u>SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA</u> | <u>29</u> |
| <u>ITEM 7.</u> | <u>MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | <u>31</u> |
| <u>ITEM 7A.</u> | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK</u> | <u>46</u> |
| <u>ITEM 8.</u> | <u>CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u> | <u>47</u> |
| <u>ITEM 9.</u> | <u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u> | <u>83</u> |
| <u>ITEM 9A.</u> | <u>CONTROLS AND PROCEDURES</u> | <u>84</u> |
| <u>ITEM 9B.</u> | <u>OTHER INFORMATION</u> | <u>87</u> |
| <u>PART III</u> | | <u>87</u> |
| <u>ITEM 10.</u> | <u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u> | <u>87</u> |
| <u>ITEM 11.</u> | <u>EXECUTIVE COMPENSATION</u> | <u>87</u> |
| <u>ITEM 12.</u> | <u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT, AND RELATED STOCKHOLDER MATTERS</u> | <u>87</u> |
| <u>ITEM 13.</u> | <u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u> | <u>88</u> |
| <u>ITEM 14.</u> | <u>PRINCIPAL ACCOUNTANT FEES AND SERVICES</u> | <u>88</u> |
| <u>PART IV</u> | | <u>88</u> |
| <u>ITEM 15.</u> | <u>EXHIBITS</u> | <u>88</u> |
| | <u>SIGNATURES</u> | <u>89</u> |

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., Virgin America Inc. (through July 20, 2018, at which point it was legally merged into Alaska Airlines, Inc.), and Horizon Air Industries, Inc. are referred to as “Alaska,” “Virgin America” and “Horizon,” respectively, and together as our “airlines.”

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.

PART I

ITEM 1. OUR BUSINESS

Alaska Air Group is a Delaware corporation incorporated in 1985 that operates two airlines, Alaska and Horizon. Alaska was organized in 1932 and incorporated in 1937 in the state of Alaska. Horizon is a Washington corporation that was incorporated and began service in 1981, and was acquired by Air Group in 1986. Virgin America was a member of Air Group since it was acquired in 2016 until 2018, when Alaska and Virgin America combined operating certificates to become a single airline, and legally merged into a single entity. The Company also includes McGee Air Services, an aviation services provider that was established as a wholly-owned subsidiary of Alaska in 2016.

Alaska and Horizon operate as separate airlines, with individual business plans, competitive factors and economic risks. Together with our regional airline partners, we fly to 115 destinations with over 1,300 daily departures through an expansive network across the U.S., Mexico, Canada, and Costa Rica. With global airline partners, we provide our guests with a network of more than 800 destinations worldwide. During 2019, we carried an all-time high 47 million guests and earned consolidated net income under Generally Accepted Accounting Principles (GAAP) of \$769 million compared to net income of \$437 million in 2018. Our adjusted net income was \$798 million, which excludes merger-related costs and mark-to-market fuel hedge adjustments. Refer to "Results of Operations" in Management's Discussion and Analysis for our reconciliation of Non-GAAP measures to the most directly comparable GAAP measure.

We organize the business and review financial operating performance by aggregating our business in three operating segments, which are as follows:

- **Mainline** - includes scheduled air transportation on Alaska's Boeing and Airbus jet aircraft for passengers and cargo throughout the U.S., and in parts of Mexico, and Costa Rica.
- **Regional** - includes Horizon's and other third-party carriers' scheduled air transportation for passengers across a shorter distance network within the U.S. under capacity purchase agreements (CPA). This segment includes the actual revenues and expenses associated with regional flying, as well as an allocation of corporate overhead incurred by Air Group on behalf of the regional operations.
- **Horizon** - includes the capacity sold to Alaska under a CPA. Expenses include those typically borne by regional airlines such as crew costs, ownership costs and maintenance costs.

Our purpose is "creating an airline people love." The "ing" is to recognize that we are never done; we are continually working to improve. We believe our success depends on our ability to provide safe air transportation, develop relationships with guests by providing exceptional customer service and low fares, and maintain a low cost structure to compete effectively. It is important to us that we achieve our objective as a socially responsible company that values not just performance, but also our people, the communities we serve, and the environment.

We marked the 16th consecutive year of profitability on an adjusted basis in 2019. Our liquidity and capital position remain strong, positioning us among other high-quality industrial companies. Due to our strong financial health and outlook, we are one of only three U.S. airlines with investment grade credit ratings. The cash generated by our continued success enables us to invest in our business to deliver profitable growth, enhance our guests' experience, and improve our financial position.

We are active in the communities we serve and strive to be an industry leader in environmental and community stewardship. In 2019, Air Group donated \$15 million in cash and in-kind travel to over 1,200 charitable organizations, and our employees volunteered more than 41,000 hours of community service related to youth and education, medical research and transportation. One of our leadership principles is to "give back" and we are proud of the efforts and voluntarism of our employees. Also in 2019, we launched LIFT, our social and environmental impact program aimed at uniting all of our social and environmental impact efforts. Through this program, our guests also showed great generosity, donating 72 million miles in 2019 for donation to charitable organizations. As recognition of our community leadership, financial stability and the fact that our combined fleet is one of the youngest and most fuel-efficient in North America, we ranked higher than any other North American airline for the third year in a row on the Dow Jones Sustainability Index.

In 2019, we completed the majority of the remaining integration milestones from our acquisition of Virgin America. During the year, Alaska flight attendants began flying as integrated crews and our pilots adopted an integrated seniority list. In July 2019, Alaska aircraft maintenance technicians, represented by the Aircraft Mechanics Fraternal Association (AMFA), ratified an

agreement bringing our last work group under a single collective bargaining agreement. We also finished painting the remainder of the Airbus fleet in the Alaska livery, and completed interior cabin renovations on 60% of the Airbus fleet.

With the integration largely behind us, we have shifted our focus towards our vision and strategy for the next five years. This strategy has three major pillars:

People:

Our success depends on our more than 24,000 employees living our values every day to deliver award-winning customer service as one team. We know engaged employees deliver higher productivity, superior execution and better guest experiences, which is why investing in our people is imperative to our future success.

In 2019, we completed Flight Path - a program that brought all Alaska and Horizon employees together through leader-led sessions to inform, engage and set the course for our business and culture. Aside from one-time programs, we continue to communicate with employees through a variety of vehicles, including weekly Leader Look Ahead and periodic live-streamed webcasts, to provide employees better information and a stronger connection to organizational priorities. Our efforts were recognized by Forbes Magazine, who named Alaska as one of the World's Best Employers for the fifth year in a row for 2019, and as one of America's Best Employers for Diversity in 2020.

Aligning our employees' goals with Air Group's goals has been an important contributor to our strong track record of accomplishments and financial performance. The majority of Alaska and Horizon employees participate in our Performance-Based Pay (PBP) and Operational Performance Rewards (OPR) programs, which encourage employees to work together to achieve metrics related to the Company's strategy - including safety, profitability, on-time performance, low costs, customer loyalty and customer satisfaction. Over the last ten years, our incentive programs have paid out on average more than one month's pay for most employees. In 2019, our employees earned more than \$150 million under these incentive programs.

Growth:

Driving growth will require our focus in a variety of areas, including a powerful brand, optimized network and strong revenue generation.

- *Powerful brand* - Providing genuine and caring service to our guests is key to our success and loyalty to the Alaska brand. This service is demonstrated daily by our employees who are empowered to make the best choices for our guests. As proof, in 2019, Alaska ranked first in the J.D. Power and Associates annual survey of customer satisfaction among traditional network carriers for the 12th year in a row. Alaska was also recognized for excellent service by Condé Nast Traveler and Travel + Leisure magazine for the second consecutive year, continuing an achievement earned by Virgin America for the preceding ten years.

Our award winning Mileage Plan™ is another way we build long-term guest relationships and grow our brand. We maintain the only distance-based frequent flier program in the United States, which rewards all fliers regardless of the price they paid for their tickets. In 2019, we increased our sign-up promotion for new cardholders to 40,000 miles, providing immediate utility of the program. We also offered promotions like Buy One Get One Free companion fares and continued popular redemption benefits, including using miles for hotel redemptions (with access to over 400,000 hotels worldwide), and adding EL AL Airlines as a new global partner.

Over the past two years, we initiated a refresh of many of our amenities with the aim of highlighting our West Coast roots. From updated on-board offerings, including fresh and local food, to local craft beers and wines, as well as updating our in-air Wi-Fi to meet the evolving needs of our guests, we will continue to innovate and evolve to provide our guests with the best experience. Work towards updated guest-facing amenities continued in 2019, with our flagship lounge opening in the North Satellite at Sea-Tac Airport, as well as the announcement of a new lounge at San Francisco International Airport, which is expected to open in the second half of 2020. We also strive to connect with West Coast guests through key sponsorships including Russell Wilson, the San Jose Sharks, San Francisco Giants, Seattle Mariners, Portland Timbers, Seattle's new NHL team, and more.

- *Optimized Network* - The acquisition of Virgin America positioned us as the fifth largest airline in the U.S., with an unparalleled ability to serve West Coast travelers. We offer the highest guest relevance of any carrier from the West Coast. Competition in our markets is significant, and we know that we must defend our customer base as we grow our network presence by providing guests with an increased choice of schedule times and fares. We are intensely focused on providing the most utility and routes to our guests. From our West Coast hub cities, we lead all other airlines in

non-stop markets, daily flights and seat share. In 2019, we began departures from Paine Field-Snohomish County Airport in Everett, Washington to ten West Coast markets. We also optimized our current network, and reallocated flying to expand offerings between the Pacific Northwest and California, increasing network utility and providing more non-stop service on the West Coast.

- *Revenue Generation* - In 2018, we introduced our Saver Fare product, which offers greater choice for our guests, allowing them to purchase and pay for the ticket type and other amenities they value most. In 2019, our Saver Fare product provided meaningful revenue growth, and is expected to continue to provide incremental revenue into 2020. This, combined with synergies from the merger, which are expected to hit their full run rate in 2021, and capacity growth, will enable us to continue to grow our annual revenues. Innovation will also be key to growth in our revenues. We will focus our efforts on merchandising and demand generation, including through a variety of unique marketing strategies aimed at increasing revenues in typically off-peak periods.

Business Model:

Safety is the foundation of everything we do and remains our top priority. We have an unwavering commitment to run a safe operation, and we will not compromise this commitment in the pursuit of other initiatives. Alaska and Horizon were the first U.S. major airlines to receive FAA validation and acceptance of their Safety Management Systems (SMS) in 2016. In 2018, we used SMS to safely and consistently guide our integration with the legacy Virgin America operation. Report It!, our mobile safety reporting application, makes it easier for employees to file safety reports. In 2018, 100% of our Alaska and Horizon aircraft technicians completed the requirements for the FAA's "Diamond Certificate of Excellence" award, marking the 17th consecutive year Alaska has received the award, and the 17th time in the last 19 years Horizon has received this award. In early 2020, we were again included as one of only two U.S. airlines on the AirlineRatings.com list of the world's Top 20 safest airlines. We believe that maintaining safe operations, through adherence to well-defined processes and ensuring every Air Group employee is aware of their individual contribution to our operation, is critical to ensuring on-time performance. The rigor we apply to running a safe operation has resulted in Alaska consistently being one of the top airlines in North America for on-time performance; and Horizon was recognized once again as the leader in on-time performance in 2019 among regional airlines.

Ultimately, our success will be driven by our business model being flexible and innovative as we drive towards our pretax margin goals of 13% to 15%, and our growth goals of 4% to 6% over the business cycle. We know that in order to provide low fares in our growing network while generating strong returns for our shareholders, it is imperative for us to maintain a competitive cost structure. In 2019, our unit costs, excluding fuel and special items, increased 2.3% on a consolidated basis. Although our unit costs are expected to rise again in 2020, primarily due to general wage inflation, higher engine maintenance on both our Airbus and B737-800 fleets, and increased lease return costs associated with our Airbus fleet, we will continue our focus on lowering overhead, improving productivity, and managing vendor costs. We are also actively managing fuel costs by flying larger, more fuel-efficient aircraft, which has increased our fuel efficiency as measured by available seat miles flown per gallon by 1.6% over the last five years. We have a long track record of effective cost control, and we remain keenly committed to protecting our unit cost advantage relative to competitors.

AIR GROUP

Our airlines operate different aircraft and missions. Alaska operates a fleet of narrowbody passenger jets on primarily longer-haul capacity. Alaska contracts primarily with Horizon and SkyWest Airlines, Inc. (SkyWest) for shorter-haul capacity, such that Alaska receives all passenger revenue from those flights. Horizon operates Embraer 175 (E175) regional jet aircraft and Bombardier Q400 turboprop aircraft and sells all of its capacity to Alaska pursuant to a CPA. The majority of our revenues are generated by transporting passengers. The percentage of revenues by category is as follows:

| | 2019 | 2018 | 2017 | 2016 ^(a) | 2015 |
|----------------------------|-------|-------|-------|---------------------|-------|
| Passenger revenue | 92 % | 93 % | 93 % | 91 % | 85 % |
| Mileage Plan other revenue | 5 % | 5 % | 5 % | 6 % | (b) |
| Cargo and other | 3 % | 2 % | 2 % | 3 % | (b) |
| Other revenue | (b) | (b) | (b) | (b) | 13 % |
| Freight and Mail revenue | (b) | (b) | (b) | (b) | 2 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

(a) Includes information for Virgin America for the period December 14, 2016 through December 31, 2016.

(b) As a result of the new revenue recognition standards, certain financial statement line items were modified to address new requirements. We did not apply this change to fiscal year 2015, and have left the captioning above as it was presented in that fiscal year.

We deploy aircraft in ways that we believe will best optimize our revenues and profitability and reduce the impacts of seasonality.

The percentage of our capacity by region is as follows:

| | 2019 | 2018 | 2017 | 2016 ^(a) | 2015 |
|---------------------------|-------|-------|-------|---------------------|-------|
| West Coast ^(b) | 28 % | 27 % | 28 % | 34 % | 36 % |
| Transcon/midcon | 44 % | 44 % | 43 % | 29 % | 24 % |
| Hawaii and Costa Rica | 14 % | 14 % | 13 % | 17 % | 18 % |
| Alaska | 10 % | 10 % | 10 % | 14 % | 15 % |
| Mexico | 3 % | 4 % | 5 % | 5 % | 6 % |
| Canada | 1 % | 1 % | 1 % | 1 % | 1 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

(a) Includes information for Virgin America for the period December 14, 2016 through December 31, 2016.

(b) Category represents flying within the West Coast. Departures from the West Coast to other regions are captured in other categories.

MAINLINE

Our Mainline operations include Boeing 737 (B737) and Airbus A320 family (A319, A320, and A321neo) jet service offered by Alaska. We offer extensive passenger service from the western U.S. throughout the contiguous United States, Alaska, Hawaii, Canada, Mexico, and Costa Rica. Our largest concentrations of departures are in Seattle, Portland, and the Bay Area. We also offer cargo service throughout our network and have three dedicated cargo aircraft that operate primarily to and within the state of Alaska.

In 2019, we carried 36 million revenue passengers in our Mainline operations. At December 31, 2019, our Mainline operating fleet consisted of 166 Boeing 737 jet aircraft and 71 Airbus A320 family jet aircraft compared to 162 B737 aircraft and 71 Airbus aircraft as of December 31, 2018.

The percentage of Mainline passenger capacity by region and average stage length is presented below:

| | 2019 | 2018 | 2017 | 2016 ^(a) | 2015 |
|------------------------------|-------|-------|-------|---------------------|-------|
| West Coast ^(b) | 23 % | 23 % | 24 % | 30 % | 31 % |
| Transcon/midcon | 46 % | 46 % | 45 % | 30 % | 27 % |
| Hawaii and Costa Rica | 16 % | 15 % | 15 % | 19 % | 20 % |
| Alaska | 11 % | 11 % | 11 % | 15 % | 16 % |
| Mexico | 4 % | 5 % | 5 % | 6 % | 6 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |
| Average Stage Length (miles) | 1,299 | 1,298 | 1,301 | 1,225 | 1,195 |

(a) Includes information for Virgin America for the period December 14, 2016 through December 31, 2016.

(b) Category represents flying within the West Coast. Departures from the West Coast to other regions are captured in other categories.

REGIONAL

Our Regional operations consist primarily of flights operated by Horizon and SkyWest. In 2019, our Regional operations carried approximately 11 million revenue passengers, primarily in the states of Washington, Oregon, Idaho and California. Horizon is the largest regional airline in the Pacific Northwest and carries approximately 70% of Air Group's regional revenue passengers.

Based on 2019 Horizon passenger enplanements on regional aircraft, our most significant concentration of regional activity was in Seattle and Portland. At December 31, 2019, Horizon's operating fleet consisted of 30 E175 jet aircraft and 33 Bombardier Q400 turboprop aircraft. The regional fleet operated by SkyWest consisted of 32 E175 aircraft.

The percentage of regional passenger capacity by region and average stage length is presented below:

| | 2019 | 2018 | 2017 | 2016 | 2015 |
|------------------------------|-------|-------|-------|-------|-------|
| West Coast | 61 % | 53 % | 59 % | 60 % | 62 % |
| Pacific Northwest | 10 % | 11 % | 13 % | 16 % | 19 % |
| Canada | 3 % | 3 % | 4 % | 5 % | 7 % |
| Alaska | 1 % | 2 % | 3 % | 4 % | 5 % |
| Midcon | 25 % | 30 % | 21 % | 15 % | 6 % |
| Mexico | — | 1 % | — % | — % | 1 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |
| Average Stage Length (miles) | 490 | 468 | 422 | 381 | 348 |

FREQUENT FLYER PROGRAM

Alaska Airlines Mileage Plan™ provides a comprehensive suite of frequent flyer benefits. Miles can be earned by flying on our airlines or on one of our 18 airline partners, by using an Alaska Airlines credit card, or through other non-airline partners. Alaska's extensive list of airline partners includes carriers associated with each of the three major global alliances, making it easier for our members to earn miles and reach elite status in our frequent flyer program. Through Alaska and our global partners, Mileage Plan™ members have access to a large network of over 800 worldwide travel destinations. Further, members can receive up to 40,000 bonus miles upon signing up for the Alaska Airlines Visa Signature card and meeting a minimum spend threshold, and earn triple miles on Alaska Airlines purchases. Alaska Airlines Visa Signature cardholders and small business cardholders in the U.S., and Platinum and World Elite Mastercard cardholders in Canada, also receive an annual companion ticket that allows members to purchase an additional ticket for \$99 plus taxes, with no restrictions or black-out dates, and a free first checked bag for up to six people traveling on the same itinerary. Earned miles can be redeemed for flights on our airlines, or our partner airlines, for hotel stays via mileageplanhotels.com, or for upgrades to First Class on Alaska Airlines. We believe all of these benefits give our Mileage Plan™ members more value than competing programs.

Mileage Plan™ revenues, including those in the Passenger revenue income statement line item, represented approximately 13% of Air Group's total revenues in 2019. Mileage Plan™ helps drive revenue growth by attracting new customers, keeping existing customers actively engaged, and building customer loyalty through the benefits that we provide.

AGREEMENTS WITH OTHER AIRLINES

Our agreements fall into three different categories: frequent flyer, codeshare and interline agreements. Frequent flyer agreements enable our Mileage Plan™ members to earn mileage credits and make redemptions on one of our 18 domestic and international partner airlines.

Codeshare agreements allow one or more marketing carriers to sell seats on a single operating carrier that services passengers under multiple flight numbers. The sale of codeshare seats can vary depending on the sale arrangement. For example, in a free-sale arrangement, the marketing carrier sells the operating carrier's inventory without any restriction; whereas in a block-space arrangement, a fixed amount of seats are sold to the marketing carrier by the operating carrier. The interchangeability of the flight code between carriers provides a greater selection of flights for customers, along with increased flexibility for mileage accrual and redemption.

Interline agreements allow airlines to jointly offer a competitive, single-fare itinerary to customers traveling via multiple carriers to a final destination. An interline itinerary offered by one airline may not necessarily be offered by the other, and the fares collected from passengers are prorated and distributed to interline partners according to preexisting agreements between the carriers. Frequent flyer, codeshare and interline agreements help increase our traffic and revenue by providing a more diverse network and schedule options to our guests.

Alaska has marketing alliances with a number of airlines that provide frequent flyer and codesharing opportunities. Alliances are an important part of our strategy and enhance our revenues by:

- offering our guests more travel destinations and better mileage credit/redemption opportunities, including elite qualifying miles on U.S. and international airline partners;

- giving our Mileage Plan™ program a competitive advantage because of our partnership with both unaffiliated international carriers and carriers from all three major worldwide alliances;
- giving us access to more connecting traffic from other airlines; and
- providing members of our alliance partners' frequent flyer programs an opportunity to travel on Alaska and our regional partners while earning mileage credit in our partners' programs.

Most of our codeshare relationships are free-sale 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 one or more may be in the process of renegotiation at any time. Our codeshare and interline agreements generated 5%, 5%, and 6% of our total marketed revenues as of December 31, 2019, 2018 and 2017.

The comprehensive summary of Alaska's alliances with other airlines is as follows:

| | Frequent Flyer Agreement | Codeshare | |
|---|--------------------------|--|--|
| | | Alaska Flight # on Flights Operated by Other Airline | Other Airline Flight # on Flights Operated by Alaska or CPA Partners |
| Major U.S. or International Airlines | | | |
| Aer Lingus | Yes | No | No |
| American Airlines | Yes | Yes | Yes |
| British Airways | Yes | No | Yes |
| Cathay Pacific Airways | Yes | No | Yes |
| Condor Airlines ^(a) | Yes | No | No |
| EL AL Israel Airlines | Yes | No | Yes |
| Emirates | Yes | No | Yes |
| Fiji Airways ^(a) | Yes | No | Yes |
| Finnair | Yes | No | Yes |
| Hainan Airlines | Yes | No | No |
| Icelandair | Yes | No | Yes |
| Japan Airlines | Yes | No | Yes |
| Korean Air | Yes | No | Yes |
| LATAM | Yes | No | Yes |
| Qantas | Yes | Yes | Yes |
| Singapore Airlines | Yes | No | No |
| Regional Airlines | | | |
| Ravn Alaska | Yes | Yes | No |
| PenAir ^(a) | Yes | Yes | No |

(a) 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.

CARGO AND OTHER REVENUE

The Company provides freight and mail services (cargo). The majority of cargo services are provided to commercial businesses and the United States Postal Service. The Company satisfies cargo service performance obligations and recognizes revenue when the shipment arrives at its final destination, or is transferred to a third-party carrier for delivery.

The Company also earns other revenue for lounge memberships, hotel and car commissions, and certain other immaterial items not intrinsically tied to providing air travel to passengers. Revenue is recognized when these services are rendered and recorded as Cargo and other revenue.

GENERAL

The airline industry is highly competitive and subject to various uncertainties, including economic conditions, volatile fuel prices, a largely unionized work force, the need to finance large capital expenditures and the related availability of capital, government regulation—including taxes and fees, 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 based on 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 to our operating and financial results. Passenger demand and ticket prices are, in large measure, influenced by the general state of the economy, current global economic and political events, and total available airline seat capacity.

In 2019, the airline industry posted another year of profits, and increases over 2018, primarily due to lower fuel prices. Although growth was impacted in 2019 following the grounding of the Boeing 737 MAX aircraft, airlines have continued to make significant investments in airports and new services to differentiate their customer service offering. Thus, the level of competition is expected to continue to increase.

FUEL

Our business and financial results are highly impacted by the price and the availability of aircraft fuel. Aircraft fuel expense includes raw fuel expense, or the price that we generally pay at the airport, including taxes and fees, plus the effect of mark-to-market adjustments to our fuel hedge portfolio as the value of that portfolio increases and decreases. The cost of aircraft fuel is volatile and outside of our control, and it can have a significant and immediate impact on our operating results. Over the past five years, aircraft fuel expense ranged from 18% to 25% of operating expenses. Fuel prices are impacted by changes in both the price of crude oil and refining costs and can vary by region in the U.S.

The price of crude oil on an average annual basis for the past five years has ranged from a low of \$43 per barrel in 2016 to a high of \$65 in 2018. For us, a \$1 per barrel change in the price of oil equates to approximately \$21 million of 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 \$9 million per year.

Refining margins, which represent the price of refining crude oil into aircraft fuel, are a smaller portion of the overall price of jet fuel, but have also contributed to the price volatility in recent years. Over the last five years, average annual West Coast refining margin prices have fluctuated from a low of \$13 per barrel in 2016 to a high of \$26 per barrel in 2019.

Generally, West Coast jet fuel prices are somewhat higher and more volatile than prices in the Gulf Coast or on the East Coast. Our average raw fuel cost per gallon decreased 6% in 2019, after increasing 28% in 2018 and increasing 21% in 2017.

The percentages of our aircraft fuel expense by crude oil and refining margins, as well as the percentage of our aircraft fuel expense of operating expenses, are as follows:

| | 2019 | 2018 | 2017 | 2016 ^(a) | 2015 |
|-----------------------|-------|-------|-------|---------------------|-------|
| Crude oil | 62 % | 68 % | 66 % | 69 % | 62 % |
| Refining margins | 28 % | 25 % | 23 % | 20 % | 26 % |
| Other ^(b) | 10 % | 7 % | 11 % | 11 % | 12 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |
| Aircraft fuel expense | 24 % | 25 % | 22 % | 18 % | 22 % |

(a) Includes information for Virgin America for the period December 14, 2016 through December 31, 2016.

(b) Other includes gains and losses on settled fuel hedges, unrealized mark-to-market fuel hedge gains or losses, taxes and other into-plane costs.

We use crude oil call options as hedges against our exposure to the volatility of jet fuel prices. Call options effectively cap our price for crude oil, limiting our exposure to increasing fuel prices for about half of our planned fuel consumption. With call options, we are hedged against spikes in crude oil prices, and during a period of declines in crude oil prices, we only forfeit cash previously paid for hedge premiums. We begin hedging approximately 18 months in advance of consumption.

We believe that operating fuel-efficient aircraft and executing on operational best practices are the best hedges against high fuel prices. Maintaining a young, fuel-efficient fleet helps to reduce our fuel consumption rate, but also the amount of greenhouse gases and other pollutants that our aircraft emit.

COMPETITION

Competition in the airline industry is intense and unpredictable. Our competitors consist primarily of other airlines and, to a lesser extent, other forms of transportation. Competition can be direct, in the form of another carrier flying the exact non-stop route, or indirect, where a carrier serves the same two cities non-stop from an alternative airport in that city or via an itinerary requiring a connection at another airport. We compete with other domestic airlines and a limited number of international airlines on nearly all of our scheduled routes. Our largest competitor is Delta Airlines Inc. (Delta), who has significantly increased its capacity in Seattle since 2013. Approximately 76% of our capacity to and from Seattle competes with Delta. As we have grown in California and have expanded our transcontinental route offerings, United Airlines and Southwest Airlines have also become large competitors and have increased their capacity in markets we serve. Our California and transcontinental routes have a higher concentration of competitors when compared to our historical route structure, which was predominately concentrated in the Pacific Northwest. Based on schedules filed with the U.S. Department of Transportation, we expect the amount of competitive capacity overlap with all carriers to increase by more than 1% in the first quarter of 2020, weighted based on our network.

We believe that the following principal competitive factors are important to our guests:

- Safety

Safety is our top priority and is at the core of everything we do. In early 2020, Alaska was again ranked by AirlineRatings.com as one of only two U.S. airlines in the Top 20 safest airlines in the world. In 2018, we also received our 17th Diamond Award of Excellence from the Federal Aviation Administration, recognizing both Alaska and Horizon aircraft technicians for their commitment to training.

- Fares and ancillary services

Ticket and other fee pricing is a significant competitive factor in the airline industry, and the increased availability of fare information on the Internet allows travelers to easily compare fares and identify competitor promotions and discounts. Pricing is driven by a variety of factors including, but not limited to, market-specific capacity, market share per route/geographic area, cost structure, fare vs. ancillary revenue strategies, and demand.

For example, airlines often discount fares to drive traffic in new markets or to stimulate traffic when necessary to improve load factors. In addition, traditional network carriers have been able to reduce their operating costs through bankruptcies and mergers, while low-cost carriers have continued to grow their fleets and expand their networks, potentially enabling them to better control costs per available seat mile (the average cost to fly an aircraft seat one mile), which in turn may enable them to lower their fares. These factors can reduce our pricing power and that of the airline industry as a whole.

Domestic airline capacity is dominated by four large carriers, representing over 80% of total seats. One of our advantages is our low fare with high value position in the industry. However, given the large concentration of industry capacity, some carriers in our markets may discount their fares substantially to develop or increase market share. Fares that are substantially below our cost to operate can be harmful if sustained over a long period of time. We will defend our core markets and, if necessary, redeploy capacity to better match supply with demand. We believe our strong financial position and low cost advantage enables us to offer competitive fares while still earning returns for our shareholders.

- Customer service and reputation

We compete with other airlines in areas of customer service such as on-time performance and guest amenities - including first class and other premium seating, quality of on-board products, aircraft type and comfort. In 2019, Alaska ranked highest in customer satisfaction among traditional network carriers by J.D. Power and Associates for the 12th year in a row, and was also named as the best U.S. airline by Condé Nast Traveler. Additionally, in 2019 we opened our new flagship lounge in the North Satellite of Sea-Tac Airport and began work on our new lounge at San Francisco International Airport.

We are also in the process of reconfiguring our Airbus aircraft, which began in 2018. The new livery and interior reconfiguration will provide guests with one consistent brand experience across the Mainline fleet. Airbus livery updates

were completed in 2019, while the interior reconfiguration is expected to wrap up in early 2021. We began installation of next-generation Gogo inflight satellite based Wi-Fi on our entire Boeing and Airbus fleets in 2018, which is planned to be complete in 2020.

Our employees are a key element of our product. We have a highly engaged workforce that strives to provide genuine and caring service to our guests, both at the airport and onboard. We heavily emphasize our service standards with our employees through training and education programs and monetary incentives related to operational performance and guest satisfaction.

- Routes served, flight schedules, codesharing and interline relationships, and frequent flyer programs

We also compete with other airlines based on markets served, the frequency of service to those markets and frequent flyer opportunities. Some airlines have more extensive route structures than we do, and they offer significantly more international routes. In order to expand opportunities for our guests, we enter into codesharing and interline relationships with other airlines that provide reciprocal frequent flyer mileage credit and redemption privileges. These relationships allow us to offer our guests access to more destinations than we can on our own, gain exposure in markets we do not serve and allow our guests more opportunities to earn and redeem frequent flyer miles. Our Mileage Plan™ offers some of the most comprehensive benefits to our members with the ability to earn and redeem miles on 18 partner carriers. For the fifth year in a row, Mileage Plan™ was ranked first in U.S. News and World Report's list of Best Travel Rewards Programs.

In addition to domestic or foreign airlines that we compete with on most of our routes, we compete with ground transportation in our short-haul markets. To some extent, our airlines 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.

TICKET DISTRIBUTION

Our tickets are distributed through three primary channels:

- *Direct to customer:* It is less expensive for us to sell through our direct channel at alaskaair.com. We believe direct sales through this channel are preferable from a branding and customer relationship standpoint in that we can establish ongoing communication with the guest and tailor offers accordingly. As a result, we continue to take steps to drive more business to our website.
- *Traditional and online travel agencies:* Both traditional and online travel agencies typically use Global Distribution Systems (GDS) 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:* Our call centers are located in Phoenix, AZ, Kent, WA, and Boise, ID. We generally charge a \$15 fee for booking reservations through the call centers.

Our sales by channel are as follows:

| | 2019 | 2018 | 2017 | 2016 (a) | 2015 |
|--------------------------|-------|-------|-------|----------|-------|
| Direct to customer | 65 % | 63 % | 62 % | 61 % | 60 % |
| Traditional agencies | 20 % | 22 % | 22 % | 23 % | 23 % |
| Online travel agencies | 11 % | 11 % | 11 % | 11 % | 11 % |
| Reservation call centers | 4 % | 4 % | 5 % | 5 % | 6 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

(a) Includes results for Virgin America for the period December 14, 2016 through December 31, 2016.

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 fewer departures and passengers. Profitability typically increases in the second quarter and then reaches its highest level during the third quarter as a result of vacation travel. However, we have significantly moderated the impact of seasonality of our operations through continued growth from the West Coast to leisure destinations, like Hawaii and Costa Rica, and expansion to leisure and business destinations in the mid-continental and eastern U.S.

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

- pricing initiatives by us or our competitors,
- changes in fuel costs,
- increases in competition at our primary airports,
- general economic conditions and resulting changes in passenger demand,
- increases or decreases in passenger and volume-driven variable costs, and
- air space and Air Traffic Control delays, particularly in Seattle and San Francisco.

Many of the markets we serve experience inclement weather conditions in the winter, causing increased costs associated with deicing aircraft, canceling flights and accommodating 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 the impact of 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

Our business is labor intensive. As of December 31, 2019, we employed 24,134 (17,919 at Alaska, 4,301 at Horizon, and 1,914 at McGee Air Services) active full-time and part-time employees. Wages and benefits, including variable incentive pay, represented approximately 43% of our total non-fuel operating expenses in 2019 and 41% in 2018.

Most major airlines, including Alaska and Horizon, have employee groups that are covered by collective bargaining agreements (CBAs). Airlines with unionized work forces generally 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 or slowing demand.

As part of the integration, we have been working to bring represented work groups under single CBAs. In 2019, our aircraft maintenance technicians, represented by the Aircraft Mechanics Fraternal Association (AMFA), ratified a two-year contract extension, bringing Airbus and Boeing technicians under a single CBA. Now all five of our unionized groups at Alaska are under joint collective agreements with integrated seniority lists in place.

At December 31, 2019, labor unions represented 86% of Alaska's, 43% of Horizon's, and 87% of McGee Air Services' employees.

Our relations with U.S. labor organizations are governed by the Railway Labor Act (RLA). Under the RLA, 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 to initiate a process including mediation, arbitration, and a potential "cooling off" period that must be followed before either party may engage in self-help.

Alaska's union contracts at December 31, 2019 were as follows:

| Union | Employee Group | Number of Employees | Contract Status |
|---|--|---------------------|----------------------|
| Air Line Pilots Association, International (ALPA) ^(a) | Pilots | 3,048 | Amendable 3/31/2020 |
| Association of Flight Attendants (AFA) | Flight attendants | 6,043 | Amendable 12/17/2021 |
| International Association of Machinists and Aerospace Workers (IAM) | Ramp service and stock clerks | 723 | Amendable 9/27/2024 |
| IAM | Clerical, office and passenger service | 4,443 | Amendable 9/27/2024 |
| Aircraft Mechanics Fraternal Association (AMFA) | Mechanics, inspectors and cleaners | 946 | Amendable 10/17/2023 |
| Mexico Workers Association of Air Transport ^(b) | Mexico airport personnel | 92 | Amendable 9/29/2019 |
| Transport Workers Union of America (TWU) | Dispatchers | 82 | Amendable 3/24/2021 |

(a) Negotiations with ALPA for an updated collective bargaining agreement are ongoing as of the date of this filing.

(b) As a result of amendments to Mexican labor laws, the Company has up to four years to make changes to the existing labor agreements. During that time, the existing contracts remain in place.

Horizon's union contracts at December 31, 2019 were as follows:

| Union | Employee Group | Number of Employees | Contract Status |
|--|---|---------------------|----------------------|
| International Brotherhood of Teamsters (IBT) | Pilots | 824 | Amendable 12/31/2024 |
| AFA ^(a) | Flight attendants | 685 | Amendable 7/18/2019 |
| AMFA | Mechanics and related classifications | 261 | Amendable 12/15/2020 |
| Unifor | Station personnel in Vancouver and Victoria, BC, Canada | 40 | Expires 2/13/2022 |
| TWU | Dispatchers | 24 | Amendable 8/26/2018 |

(a) Negotiations with AFA for an updated collective bargaining agreement are ongoing as of the date of this filing.

McGee Air Services union contract at December 31, 2019 was as follows:

| Union | Employee Group | Number of Employees | Contract Status |
|-------|------------------------|---------------------|---------------------|
| IAM | Fleet and ramp service | 1,664 | Amendable 7/19/2023 |

EXECUTIVE OFFICERS

The executive officers of Alaska Air Group, Inc. and its primary subsidiaries, Alaska Airlines, Inc. and Horizon Air Industries, who have significant decision-making responsibilities, their positions and their respective ages are as follows:

| Name | Position | Age | Air Group or Subsidiary Officer Since |
|---------------------|--|-----|---------------------------------------|
| Bradley D. Tilden | Chairman and Chief Executive Officer of Alaska Air Group, Inc., Chairman of Alaska Airlines, Inc., Chairman of Horizon Air Industries, Inc. | 59 | 1994 |
| Brandon S. Pedersen | Executive Vice President/Finance and Chief Financial Officer of Alaska Air Group, Inc. and Alaska Airlines, Inc., and Treasurer of Alaska Air Group, Inc. and Alaska Airlines, Inc. | 53 | 2003 |
| Kyle B. Levine | Senior Vice President Legal, General Counsel and Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc. and Chief Ethics and Compliance Officer of Alaska Air Group, Inc. | 48 | 2016 |
| Benito Minicucci | President of Alaska Airlines, Inc. | 53 | 2004 |
| Joseph A. Sprague | President of Horizon Air Industries, Inc. | 51 | 2019 |
| Gary L. Beck | Executive Vice President and Chief Operating Officer of Alaska Airlines, Inc. | 72 | 2018 |
| Andrew R. Harrison | Executive Vice President and Chief Commercial Officer of Alaska Airlines, Inc. | 50 | 2008 |
| Shane R. Tackett | Executive Vice President, Planning and Strategy of Alaska Airlines, Inc. | 41 | 2011 |
| Andrea L. Schneider | Senior Vice President People of Alaska Airlines, Inc. | 54 | 1998 |
| Diana Birkett-Rakow | Vice President External Relations of Alaska Airlines, Inc. | 42 | 2017 |

Mr. Tilden joined Alaska Airlines in 1991, became Controller of Alaska Air Group and Alaska Airlines in 1994 and was named Vice President/Finance at Alaska Airlines in January 1999 and at Alaska Air Group in February 2000. He was elected Alaska Airlines Chief Financial Officer in February 2000, Executive Vice President/Finance and Chief Financial Officer of both companies in January 2002 and Executive Vice President/Finance and Planning of Alaska Airlines in April 2007. Mr. Tilden was named President of Alaska Airlines in December 2008 and, in May 2012, he was elected President and CEO of Alaska Air Group and Alaska Airlines and CEO of Horizon Air. He leads Air Group's Management Executive Committee and was elected to the Air Group Board in 2010 and became Chairman of the Board in January 2014.

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 Chief Financial Officer of Alaska Air Group and Alaska Airlines in June 2010 and Executive Vice President/Finance and Chief Financial Officer of both entities in 2014. Effective February 2019, he was elected Treasurer of Alaska Air Group and Alaska Airlines. He was Chief Financial Officer of Virgin America Inc. from December 2016 to July 2018, when Virgin America was merged into Alaska. He is a member of Air Group's Management Executive Committee. Mr. Pedersen will retire effective March 2, 2020 and Mr. Tackett will assume the role of Chief Financial Officer.

Mr. Levine was elected Senior Vice President Legal and General Counsel of Alaska Air Group and Alaska Airlines in January 2020 and is a member of Air Group's Management Executive Committee. Mr. Levine was previously Vice President Legal and General Counsel of Alaska Air Group and Alaska Airlines (January 2016 - January 2020). He was elected Corporate Secretary of Alaska Air Group and Alaska Airlines in August 2017. Mr. Levine joined Alaska Airlines in February 2006 as a Senior Attorney. He also served as Associate General Counsel and Managing Director Commercial Law and General Litigation from

July 2009 to February 2011 and, subsequently, as Deputy General Counsel and Managing Director of Legal at Alaska Airlines from February 2011 to January 2016. He was appointed Assistant Corporate Secretary of Horizon Air in August 2017 and was Assistant Corporate Secretary of Virgin America from November 2017 to July 2018, when Virgin America was merged into Alaska.

Mr. Minicucci was elected President of Alaska Airlines in May 2016. Prior to that he was Executive Vice President/Operations of Alaska Airlines from December 2008 to May 2016, and was Alaska's Chief Operating Officer from December 2008 until November 2019. He was Chief Executive Officer of Virgin America Inc. from December 2016 to July 2018, when Virgin America was merged into Alaska. He is a member of Air Group's Management Executive Committee.

Mr. Sprague was elected President of Horizon Air effective November 6, 2019 and is a member of Air Group's Management Executive Committee. Mr. Sprague previously served as Senior Vice President External Relations of Alaska Airlines from May 2014 until his resignation in September 2017. Mr. Sprague also served Alaska Airlines as Vice President of Marketing from March 2010 to April 2014 and Vice President of Alaska Air Cargo from April 2008 to March 2010.

Mr. Harrison joined Alaska Airlines in 2003 as the Managing Director of Internal Audit and was elected Vice President of Planning and Revenue Management in 2008. He was elected Senior Vice President of Planning and Revenue Management in 2014. He was elected Executive Vice President and Chief Revenue Officer in February 2015 and named Executive Vice President and Chief Commercial Officer in August 2015. He is a member of Air Group's Management Executive Committee.

Mr. Beck was elected Executive Vice President and Chief Operating Officer of Alaska Airlines effective November 6, 2019 and is a member of Air Group's Management Executive Committee. Prior to that he served as President and CEO of Horizon Air from January 2018 – November 2019. Mr. Beck previously served as Vice President, Flight Operations at Alaska Airlines, Inc. until retiring in June 2015. Following that date, he provided consulting services to Alaska Airlines, Inc. in connection with the integration to a single operating certificate with Virgin America Inc.

Mr. Tackett was elected Executive Vice President of Planning and Strategy in September 2018 and is a member of Air Group's Management Executive Committee. Mr. Tackett previously served as Senior Vice President of Revenue and E-commerce from August 2017 to September 2018 and has served a number of capacities since joining Alaska Airlines in 2000, including Managing Director Financial Planning and Analysis, (2008-2010), Vice President Labor Relations (2010-2015) and Vice President Revenue Management in 2016. Mr. Tackett will assume the role of Chief Financial Officer concurrent with Mr. Pedersen's retirement in March 2020.

Ms. Schneider was elected Senior Vice President of People at Alaska Airlines in June 2019 and is a member of Air Group's Management Executive Committee. Ms. Schneider was previously Vice President of People at Alaska (August 2017-May 2019) Vice President of Inflight Services at Alaska (2011-2017), later also taking responsibility for Call Centers at Alaska (February 2017). She began her career at Alaska as Manager of Financial Accounting in 1989. Since that time, she has held a number of positions.

Ms. Birkett-Rakow was elected Vice President of External Relations at Alaska Airlines in September 2017 and became a member of Air Group's Management Executive Committee at that time.

REGULATION

GENERAL

The airline industry is highly regulated, most notably by the federal government. The Department of Transportation (DOT), the the Transportation Security Administration (TSA) and the FAA exercise significant regulatory authority over air carriers.

- *DOT*: A domestic airline is required to hold a certificate of public convenience and necessity issued by the DOT in order to provide passenger and cargo air transportation in the U.S. 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. While airlines are permitted to establish their own fares without government regulation, 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, carrier liability for personal or property damage, and certain airport rates and charges disputes. 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 been active in implementing a variety of "consumer protection" regulations, covering subjects such

as advertising, passenger communications, denied boarding compensation and tarmac delay response. Airlines are subject to enforcement actions that are brought by the DOT for alleged violations of consumer protection and other economic regulations. We are not aware of any enforcement proceedings that could either materially affect our financial position or impact our authority to operate.

- *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. Each maintenance program provides for the ongoing maintenance of the relevant aircraft type, ranging from frequent routine inspections to major overhauls. Periodically, 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. Under TSA authority, we are required to collect a September 11 Security Fee of \$5.60 per one-way trip from passengers and remit that sum to the government to fund aviation security measures. Airlines are subject to enforcement actions that are brought by the TSA 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.

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 RLA. 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 and international treaties.

We are also subject to the oversight of the Occupational Safety and Health Administration (OSHA) concerning employee safety and health matters. The 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 employee safety and health laws and regulations. We maintain our safety and health programs in order to meet or exceed these requirements.

ENVIRONMENTAL

We are also subject to various laws and government regulations concerning environmental matters, both domestically and internationally. Domestic regulations that have an impact to our operations include the Airport Noise and Capacity Act of 1990, the Clean Air Act, Resource Conservation and Recovery Act, Clean Water Act, Safe Drinking Water Act, the Comprehensive Environmental Response and Compensation Liability Act, the National Environmental Policy Act, Emergency Planning and Community Right-to-Know Act and the Toxic Substances Control Act. Many state and local environmental regulations exceed these federal regulations. In the future there may be incremental legislation aimed at reduction of carbon and other greenhouse gas emissions and environmental restoration.

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.

The impacts of carbon emissions generated by the airline industry and the impact of those emissions on climate change have faced increased scrutiny. We committed to carbon neutral international growth starting in 2020 through our commitment to Carbon Offsetting and Reduction Scheme for International Aviation, a global, market-based emissions offset program issued by the International Civil Aviation Organization. This does not have a direct impact on domestic flights, however EPA is expected to finalize a rule in 2020 on aircraft emission standards which will align with the international agreements.

Over the course of several years, we have transitioned to more fuel-efficient aircraft fleets, added fuel-efficient winglets, and flown efficient flight paths, keeping with our industry commitments towards emission reduction. In 2016, Alaska Airlines flew the first commercial flight in the U.S. using a sustainable alternative jet fuel of a 20% blend made from forest residuals. The fuel from that flight was produced by the Northwest Advanced Renewables Alliance (NARA), led by Washington State University. Alaska Airlines has joined with others at Seattle Tacoma International Airport and San Francisco International

Airport to strengthen the pathway to commercially viable sustainable aviation fuel, and through a partnership with Neste continues to assess the increased use of biofuels as an alternative fuel to reduce carbon dioxide emissions. In addition, Alaska Airlines and Horizon Air continue to utilize electric equipment at airports when we have the infrastructure to support it.

Overall, the total Alaska mainline Greenhouse Gas emissions and intensity trend has decreased since 2009 and future goals have been set to continue reducing emissions intensity. More broadly, we know that being responsible for our impact is a critical part of delivering value for all those who depend on us – employees, communities, guests, and owners – over the long term. To that end, we focused on addressing the breadth of our most significant environmental impact across emissions and waste, as well as important social impacts. Alaska Airlines leads the industry in inflight recycling and has reduced waste to landfill by over 15,000 tons over the past decade. In 2018 we were the first US airlines to remove plastic straws and stir sticks from our aircraft and in 2019, we launched a campaign called #FillBeforeYouFly to engage our employees and guests in reducing plastic waste. For more details on Alaska's emission reductions programs as well as status on other key environmental initiatives, see Alaska's annual Sustainability Reports and environmental performance metrics on our website, www.flysustainably.com/reports. The information contained on our sustainability website is not a part of this annual report on Form 10-K.

Although we do not currently anticipate that specific environmental regulation 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.

INSURANCE

We carry insurance of types customary in the airline industry and in amounts deemed adequate to protect our interests and property and to comply both with federal regulations and certain credit and lease agreements. The insurance policies principally provide coverage for Airline Hull, Spares and Comprehensive Legal Liability, War and Allied Perils, and Workers' Compensation. In addition, we currently carry a Cyber Insurance policy in the event of security breaches from malicious parties.

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

GLOSSARY OF TERMS

Aircraft Utilization - block hours per day; this represents the average number of hours per day our aircraft are in transit

Aircraft Stage Length - represents the average miles flown per aircraft departure

ASMs - available seat miles, or "capacity"; represents total seats available across the fleet multiplied by the number of miles flown

CASM - operating costs per ASM, or "unit cost"; represents all operating expenses including fuel and special items

CASMex - operating costs excluding fuel and special items per ASM; this metric is used to help track progress toward reduction of non-fuel operating costs since fuel is largely out of our control

Debt-to-capitalization ratio - represents adjusted debt (long-term debt plus capitalized operating lease liabilities) divided by total equity plus adjusted debt

Diluted Earnings per Share - represents earnings per share (EPS) using fully diluted shares outstanding

Diluted Shares - represents the total number of shares that would be outstanding if all possible sources of conversion, such as stock options, were exercised

Economic Fuel - best estimate of the cash cost of fuel, net of the impact of our fuel-hedging program

Free Cash Flow -total operating cash flow generated less cash paid for capital expenditures

Free Cash Flow Conversion - free cash flow as a percentage of adjusted net income

Load Factor - RPMs as a percentage of ASMs; represents the number of available seats that were filled with paying passengers

Mainline - represents flying Boeing 737, Airbus 320 family and Airbus 321neo jets and all associated revenues and costs

Net adjusted debt - long-term debt, including current portion, plus capitalized operating leases, less cash and marketable securities

Net adjusted debt to EBITDAR - represents net adjusted debt divided by EBITDAR (trailing twelve months earnings before interest, taxes, depreciation, amortization, special items and rent)

Productivity - number of revenue passengers per full-time equivalent employee

RASM - operating revenue per ASMs, or "unit revenue"; operating revenue includes all passenger revenue, freight & mail, Mileage Plan™ and other ancillary revenue; represents the average total revenue for flying one seat one mile

Regional - represents capacity purchased by Alaska from Horizon, SkyWest and PenAir. In this segment, Regional records actual on-board passenger revenue, less costs such as fuel, distribution costs, and payments made to Horizon, SkyWest and PenAir under the respective capacity purchased arrangement (CPA). Additionally, Regional includes an allocation of corporate overhead such as IT, finance, and other administrative costs incurred by Alaska and on behalf of Horizon

RPMs - revenue passenger miles, or "traffic"; represents the number of seats that were filled with paying passengers; one passenger traveling one mile is one RPM

Yield - passenger revenue per RPM; represents the average revenue for flying one passenger one mile

ITEM 1A. RISK FACTORS

If any of the following occurs, our business, financial condition and results of operations could be harmed. 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 as well as align these risks with Board oversight. These enterprise-wide 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 loss of life and result in a loss of confidence in our Company by the flying public and/or aviation authorities. We could experience significant claims from injured passengers, bystanders and surviving relatives, as well as costs for the repair or replacement of a damaged aircraft and 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 economic losses from such an event. 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 it is fully insured and does not involve one of our aircraft, could cause a public perception that our airlines or the aircraft we or our partners fly are less safe or reliable than other transportation alternatives. This would harm our business.

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

As is the case for all airlines, our operations often are affected by delays, cancellations and other conditions caused by factors largely beyond our control.

Factors that might impact our operations include:

- congestion, construction, and/or space constraints at airports, specifically in our hub locations of Seattle, Los Angeles, and San Francisco;
- air traffic control problems;
- adverse weather conditions;
- lack of operational approval (e.g. new routes, aircraft deliveries, etc.);
- increased security measures or breaches in security;
- contagious illness and fear of contagion;
- changes in international treaties concerning air rights;
- international or domestic conflicts or terrorist activity; and
- other changes in business conditions.

Due to our concentration of flights in the Pacific Northwest and Alaska, we believe a large portion of our operation is more susceptible to adverse weather conditions than other carriers. 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.

Changes in government regulation imposing additional requirements and restrictions on our operations 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 require substantial compliance costs. In the last several years, Congress has passed laws, and the U.S. DOT, the TSA and the FAA have issued regulations that have required significant expenditures relating to maintenance of aircraft, operation of airlines and broadening of consumer protections.

Similarly, there are a number of legislative and regulatory initiatives and reforms at the federal, state and local levels. These initiatives include increasingly stringent laws to protect the environment, minimum wage requirements, mandatory paid sick or family leave, and health care mandates. These laws could affect our relationship with our workforce and the vendors that serve our airlines and cause our expenses to increase without an ability to pass through these costs. New initiatives with employer-funded costs, specifically those impacting Washington State, could disproportionately increase our cost structure as compared

to our competitors. In recent years, the airline industry has experienced an increase in litigation over the application of state and local employment laws, particularly in California. Application of these laws may result in operational disruption, increased litigation risk, and impact on negotiated labor agreements.

Almost all commercial service airports are owned and/or operated by units of local or state governments. Airlines are largely dependent on these governmental entities to provide adequate airport facilities and capacity at an affordable cost. Many airports have increased their rates and charges to air carriers to reflect higher costs of security, updates to infrastructure and other. Additional laws, regulations, taxes, airport rates and airport charges may be occasionally proposed 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. Additionally, changes in laws and regulations at the local level may be difficult to track and maintain compliance. Any instances of non-compliance could result in additional fines and fees.

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

Terrorist attacks, the fear of such attacks or other hostilities involving the U.S. could have a significant negative effect on the airline industry, including us, and could:

- significantly reduce passenger traffic and yields as a result of a 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, which could expose us to disruptions in our operation or unexpected cost increases.

We rely on outside vendors for a variety of services and functions critical to our business, including airframe and engine maintenance, regional flying, ground handling, fueling, computer reservation system hosting, telecommunication systems, information technology infrastructure and services, and deicing, among others.

Even though we strive to formalize agreements with these vendors that define expected service levels, our use of outside vendors increases our exposure to several risks. In the event that one or more vendors go 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.

Operation of a multi-aircraft type fleet may present standardization and training challenges.

We strive for operational efficiency, which has historically been aided by our operation of a single aircraft type fleet at each operating company. With our acquisition of Virgin America, we added additional aircraft types to our mainline fleet. Certain procedures and training remain to be completed in order to ensure standardized operations for our crews and technicians as well as a seamless experience for our guests. Any failure to complete these procedures and training may create adverse impacts on guests, employees, and our ability to run an operationally efficient airline.

STRATEGY

The airline industry is highly competitive and susceptible to price discounting and changes in capacity, which could have a material adverse effect on our business. If we cannot successfully compete in the marketplace, our business, financial condition, and operating results will be materially adversely affected.

The U.S. airline industry is characterized by substantial price competition. In recent years, the market share held by low-cost carriers and ultra low-cost carriers has increased significantly and is expected to continue to increase. Airlines also compete for market share by increasing or decreasing their capacity, route systems, and the number of markets served. Several of our competitors have increased their capacity in markets we serve, particularly in our key West Coast markets. The resulting increased competition in both domestic and international markets may have a material adverse effect on our results of operations, financial condition, or liquidity.

We strive toward maintaining and improving our competitive cost structure by setting aggressive unit cost-reduction goals. This is an important part of our business strategy of offering the best value to our guests through low fares while achieving acceptable profit margins and return on capital. If we are unable to maintain our cost advantage over the long-term and achieve sustained targeted returns on invested capital, we will likely not be able to grow our business in the future or weather industry downturns. Therefore, our financial results may suffer.

The airline industry may undergo further restructuring, consolidation, or the creation or modification of alliances or joint ventures, any of which could have a material adverse effect on our business, financial condition and results of operations.

We continue to face strong competition from other carriers due to restructuring, consolidation, and the creation and modification of alliances and joint ventures. Since deregulation, both the U.S. and international airline industries have experienced consolidation through a number of mergers and acquisitions. Carriers may also improve their competitive positions through airline alliances, slot swaps/acquisitions and/or joint ventures. Certain airline joint ventures further competition by allowing airlines to coordinate routes, pool revenues and costs, and enjoy other mutual benefits, achieving many of the benefits of consolidation.

Our concentration in certain markets could cause us to be disproportionately impacted by adverse changes in circumstances in those locations.

Our strategy includes being the premier carrier for people living on the West Coast. This results in a high concentration of our business in key West Coast markets. A significant portion of our flights occur to and from our Seattle, Portland, and Bay Area hubs. In 2019, passengers to and from Seattle, Portland, and the Bay Area accounted for 83% of our total guests.

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, if sustained, 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 and Airbus as its sole suppliers for aircraft and many aircraft parts. Horizon is similarly dependent on De Havilland and Embraer. Additionally, each carrier is dependent on sole suppliers for aircraft engines for each aircraft type. As a result, we are more vulnerable to issues 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. Should we be unable to resolve known issues with certain of our aircraft or engine suppliers, it may result in the inability to operate our aircraft for extended periods. Should these suppliers be unable to manufacture or deliver new aircraft, we may not be able to grow our fleet at our intended rate, which could impact our financial position. Specifically, the Boeing 737 MAX aircraft was grounded by the FAA in March 2019 and remains grounded. We have 32 MAX9 aircraft on order, with 10 aircraft deliveries currently anticipated in 2020. If we are unable to receive these aircraft and future aircraft in a timely manner, our growth plans could be significantly impacted. Additionally, further consolidation amongst aircraft and aircraft parts manufacturers could further limit the number of suppliers. This could result in an inability to operate our aircraft or instability in the foreign countries in which the aircraft and its parts are manufactured.

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

Our airlines are parties to marketing agreements with a number of domestic and international air carriers, or “partners.” 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 credit on or redeem credit for partner flights and vice versa. We receive revenue from flights sold under codeshare and from interline arrangements. In addition, we believe that the frequent flyer arrangements are an important part of our frequent flyer program. The loss of a significant partner through bankruptcy, consolidation, or otherwise, could have a negative effect on our revenues or the attractiveness of our Mileage Plan™ program, which we believe is a source of competitive advantage.

We routinely engage in analysis and discussions regarding our own strategic position, including alliances, codeshare arrangements, interline arrangements, and frequent flyer program enhancements, and will continue to have future discussions with other airlines regarding similar activities. If other airlines participate in consolidation or reorganization, those airlines may significantly improve their cost structures or revenue generation capabilities, thereby potentially making them stronger competitors of ours and potentially impairing our ability to realize expected benefits from our own strategic relationships.

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

The airline industry, which is subject to relatively high fixed costs and highly variable and unpredictable demand, is particularly sensitive to changes in economic conditions. We are also highly dependent on U.S. consumer confidence and the health of the U.S. economy. Unfavorable U.S. economic conditions have historically driven changes in travel patterns and have resulted in reduced spending for both leisure and business travel. For some consumers, leisure travel is a discretionary expense, and shorter distance travelers, in particular, have the option to replace air travel with surface travel. Businesses are able to forgo air travel by using communication alternatives such as videoconferencing or may be more likely to purchase less expensive tickets to reduce costs, which can result in a decrease in average revenue per seat. Unfavorable economic conditions also hamper the ability of airlines to raise fares to counteract increased fuel, labor and other costs. Unfavorable or even uncertain economic conditions could negatively affect our financial condition and results of operations.

INFORMATION TECHNOLOGY

We rely heavily on automated systems to operate our business, and a failure to invest in new technology or a disruption of our current 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, mobile devices, and other systems. Substantially all of our tickets are issued to our guests as electronic tickets, and the majority of our guests check-in using our website, airport kiosks, or our mobile application. 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, we must continue to invest in new technology to ensure that our website, reservation system and check-in systems are able to accommodate a high volume of traffic, maintain information security 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 guests to do business with another airline. In addition, we rely on other automated systems for crew scheduling, flight dispatch and other operational needs. We are in the final stages of moving our primary data facility. Disruptions, failed migration, untimely recovery, or a breach of these systems or the data center 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.

Failure to appropriately comply with information security rules and regulations or safeguard our employee or guest data could result in damage to our reputation and cause us to incur substantial legal and regulatory cost.

We accept, store and transmit information about our guests, our employees, our business partners, and our business. Many international and U.S. jurisdictions have established or are in the process of establishing their own data security and privacy regulatory framework with which we, our business partners, and our corporate customers must comply. There are also various bills pending at the U.S. state and federal levels that could impose additional privacy and data security obligations. This uncertain and increasingly complex regulatory environment may result in significant expenses associated with increased investment in technology and the development of new operational processes, particularly as we continue to collect and retain large amounts of personal information. If our online activities or our other customer-facing technology systems do not function as designed, we may experience a loss of customer confidence, decreased sales, or be exposed to fraud, any of which could materially and adversely affect our reputation and operations. In addition, we frequently rely on third-party hosting sites and data processors, including cloud providers. To the extent that either we or third parties with whom we share information are found to be out of compliance with applicable laws and regulations, we could be subject to additional litigation, regulatory risks and reputational harm.

Cyber security threats have and will continue to impact our business. Failure to appropriately mitigate these risks could negatively impact our operations, reputation and financial condition.

Our sensitive information is securely transmitted over public and private networks. Our systems are subject to increasing and evolving cyber security risks. Unauthorized parties have attempted and continue to attempt to gain access to our systems and information, including through fraudulent misrepresentation and other means of deception. Methods used by unauthorized parties are continually evolving and may be difficult to identify. Because of these ever-evolving risks and regular attacks, we continue to review policies and educate our people on various methods utilized in attempts to gain unauthorized access to bolster awareness and encourage cautionary practices. However, the nature of these attacks means that proper policies and education may not be enough to prevent all unauthorized access. A compromise of our systems, the security of our infrastructure or those of other business partners that result in our information being accessed or stolen by unauthorized persons could adversely affect our operations and our reputation.

FINANCIAL CONDITION AND FINANCIAL MARKETS

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

Fuel costs constitute a significant portion of our total operating expenses. Future increases in the price of jet fuel may harm our business, financial condition and results of operations unless we are able to increase fares and fees or add additional ancillary services to attempt to recover increasing fuel costs.

Our indebtedness and other fixed obligations could lead to liquidity constraints that may restrict our activities.

We carry, and will continue to carry for the foreseeable future, a substantial amount of debt related to aircraft lease and financing commitments. Although we aim to keep our leverage low, due to our high fixed costs, including such aircraft lease commitments and debt service, a decrease in revenues would result 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, 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; or limit our ability to withstand competitive pressures and reduce our flexibility in responding to changing business and economic conditions.

Although we have historically been able to generate sufficient cash flow from our operations to pay our debt and other fixed obligations when 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.

Our maintenance costs will increase as our fleet ages, and we will periodically incur substantial maintenance costs due to the timing of maintenance events of our aircraft.

As of December 31, 2019, the average age of our NextGen aircraft (B737-700, -800, -900, -900ERs) was approximately 8.9 years, the average age of our A319, A320, and A321neo aircraft was approximately 8.6 years, the average age of our owned E175 aircraft was approximately 1.6 years, and the average age of our Q400 aircraft was approximately 11.7 years. Currently, our newer aircraft require less maintenance than they will in the future. Any significant increase in maintenance expenses could have a material adverse effect on our results of operations. In addition, expenses for aircraft coming off lease could result in unplanned maintenance expense as we are required to return the leased planes in a contractually specified condition.

The application of the acquisition method of accounting resulted in us recording a significant amount of goodwill, which could result in significant future impairment charges and negatively affect our financial results.

In accordance with acquisition accounting rules, we recorded goodwill on our consolidated balance sheet to the extent the Virgin America acquisition purchase price exceeded the net fair value of Virgin America's tangible and identifiable intangible assets and liabilities as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least annually. We could record impairment charges in our results of operations as a result of, among other items, extreme fuel price volatility, a significant decline in the fair value of certain tangible or intangible assets, unfavorable trends in forecasted results of operations and cash flows, uncertain economic environment and other uncertainties. We can provide no assurance that a significant impairment charge will not occur in one or more future periods. Any such charges may materially negatively affect our financial results.

BRAND AND REPUTATION

As we evolve our brand to appeal to a changing demographic and grow into new markets, we will engage in strategic initiatives that may not be favorably received by all of our guests.

We continue to focus on strategic initiatives designed to increase our brand appeal to a diverse and evolving demographic of airline travelers. These efforts could include significant enhancements to our in-airport and on-board environments, increasing our direct customer relationships through improvements to our purchasing portals (digital and mobile) and optimization of our customer loyalty programs. In pursuit of these efforts we may negatively affect our reputation with some of our existing customer base.

The Company's brand and reputation could be harmed if it is exposed to significant negative publicity distributed through social media.

We operate in a highly visible industry that has significant exposure to social media. Negative publicity, including as a result of misconduct by our guests or employees, can spread rapidly through social media. Should the Company not respond in a timely and appropriate manner to address negative publicity, the Company's brand and reputation may be significantly harmed. Such harm could have a negative impact on our financial results.

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 remain a significant component of our total expenses. In addition to costs associated with represented employee groups, labor costs could also increase for non-unionized employees and via vendor agreements as we work to compete for highly skilled and qualified employees against the major U.S. airlines and other businesses in a thriving job market. Although ample efforts have been dedicated to right-sizing our management structure following the merger with Virgin America, these increased labor costs may adversely affect our financial performance.

Should employees engage in job actions, such as slow-downs, sick-outs, or other actions designed to disrupt normal operations and pressure the employer to acquiesce to bargaining demands during Section 6 negotiations, although unlawful until after lengthy mediation attempts, the operation could be significantly impacted. Although we have a long track record of fostering good communications, negotiating approaches and developing other strategies to enhance workforce engagement in our long-term vision, unsuccessful attempts to strengthen relationships with union employees or loss of key personnel could divert management's attention from other projects and issues, which could adversely affect our business and results of operations.

The inability to attract, retain and train qualified personnel, or maintain our culture, could result in guest impacts and adversely affect our business and results of operations.

We compete against other major U.S. airlines for pilots, aircraft technicians and other skilled labor. As more pilots in the industry approach mandatory retirement age, the U.S. airline industry may be affected by a pilot shortage. Attrition beyond normal levels, the inability to attract new pilots, or our key vendors' inability to attract and retain mechanics or other skilled labor positions could negatively impact our operating results. As a result, our business prospects could be harmed. Additionally, we may be required to increase our wage and benefit packages, or pay increased rates to our vendors, to retain these positions. This would result in increased overall costs and may adversely impact our financial position.

Our success is also dependent on cultivating and maintaining a united culture with cohesive values and goals. Much of our continued success is tied to our guest loyalty. Failure to maintain and grow the Alaska culture could strain our ability to maintain relationships with guests, suppliers, employees and other constituencies. As part of this process, we may continue to incur substantial costs for employee programs.

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, 2019:

| Aircraft Type | Seats | Owned | Leased | Total | Average Age in Years |
|----------------------|---------|-------|--------|-------|----------------------|
| B737 Freighters | — | 3 | — | 3 | 18.9 |
| B737 NextGen | 124-178 | 153 | 10 | 163 | 8.9 |
| A319/A320 | 119-150 | 10 | 51 | 61 | 9.7 |
| A321neo | 185-190 | — | 10 | 10 | 1.7 |
| Total Mainline Fleet | | 166 | 71 | 237 | 8.9 |
| Q400 | 76 | 26 | 7 | 33 | 11.7 |
| E175 | 76 | 30 | 32 | 62 | 2.3 |
| Total Regional Fleet | | 56 | 39 | 95 | 5.6 |
| Total | | 222 | 110 | 332 | 8.0 |

"Management's Discussion and Analysis of Financial Condition and Results of Operations" discusses future orders and options for additional aircraft. "Liquidity and Capital Resources" provides more information about aircraft that are used to secure long-term debt arrangements or collateralize credit facilities. Note 6 to the Consolidated Financial Statements provides more information regarding leased aircraft as capitalized on our Consolidated Balance Sheets.

Alaska's leased B737 aircraft have lease expiration dates between 2020 and 2028. Alaska's leased A319, A320, and A321neo aircraft have expiration dates between 2020 and 2031. Horizon's leased Q400 aircraft have expiration dates between 2022 and 2023. The leased E175 aircraft are through our capacity purchase agreement with SkyWest, which extends through 2030. Alaska has the option to extend some of the leases for additional periods.

GROUND FACILITIES AND SERVICES

In various cities in the state of Alaska, we own terminal buildings and two multi-bay hangars. We also own several buildings located at or near Seattle-Tacoma International Airport (Sea-Tac). These include a multi-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 data center, and various other commercial office buildings. Additionally, in 2018 we began developing a property near our existing headquarters facility for additional office space.

At the majority of the airports we serve, we lease ticket counters, gates, cargo and baggage space, ground equipment, office space and other support areas. Airport leases contain provisions for periodic adjustments of lease rates. We are typically responsible for maintenance, insurance and other facility-related expenses and services under these agreements. We also lease operations, training, administrative, and data center facilities in Burlingame, CA; Portland, OR; Quincy, WA; and Spokane, WA, line maintenance stations in Boise, ID; San Jose, CA; Redmond, OR; Seattle, WA; Kent, WA; and Spokane, WA, and call center facilities in Phoenix, AZ, Boise, ID, and Kent, WA, and a multi-bay hangar in Portland, OR.

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.

In 2015, three flight attendants filed a class action lawsuit seeking to represent all Virgin America flight attendants for damages based on alleged violations of California and City of San Francisco wage and hour laws. The court certified a class of approximately 1,800 flight attendants in November 2016. The Company believes the claims in this case are without factual and legal merit.

In July 2018, the Court granted in part Plaintiffs' motion for summary judgment, finding Virgin America, and Alaska Airlines, as a successor-in-interest to Virgin America, responsible for various damages and penalties sought by the class members. On February 4, 2019, the Court entered final judgment against Virgin America and Alaska Airlines in the amount of approximately \$78 million. It did not award injunctive relief against Alaska Airlines.

The Company is seeking an appellate court ruling that the California laws on which the judgment is based are invalid as applied to national airlines pursuant to the U.S. Constitution and federal law and for other employment law and improper class certification reasons. The Company remains confident that a higher court will respect the federal preemption principles that were enacted to shield inter-state common carriers from a patchwork of state and local wage and hour regulations such as those at issue in this case and agree with the Company's other bases for appeal. For these reasons, no loss has been accrued.

The Company is involved in other litigation around the application of state and local employment laws, like many air carriers. Our defenses are similar to those identified above, including that the state and local laws are preempted by federal law and are unconstitutional because they impede interstate commerce. None of these additional disputes are material.

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, 2019, there were 131,812,173 shares of common stock of Alaska Air Group, Inc. issued, 123,000,307 shares outstanding, and 2,131 shareholders of record. In 2019, we paid quarterly dividends of 0.35 per share in March, June, September and December. Our common stock is listed on the New York Stock Exchange (symbol: ALK).

SALES OF NON-REGISTERED SECURITIES

None.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

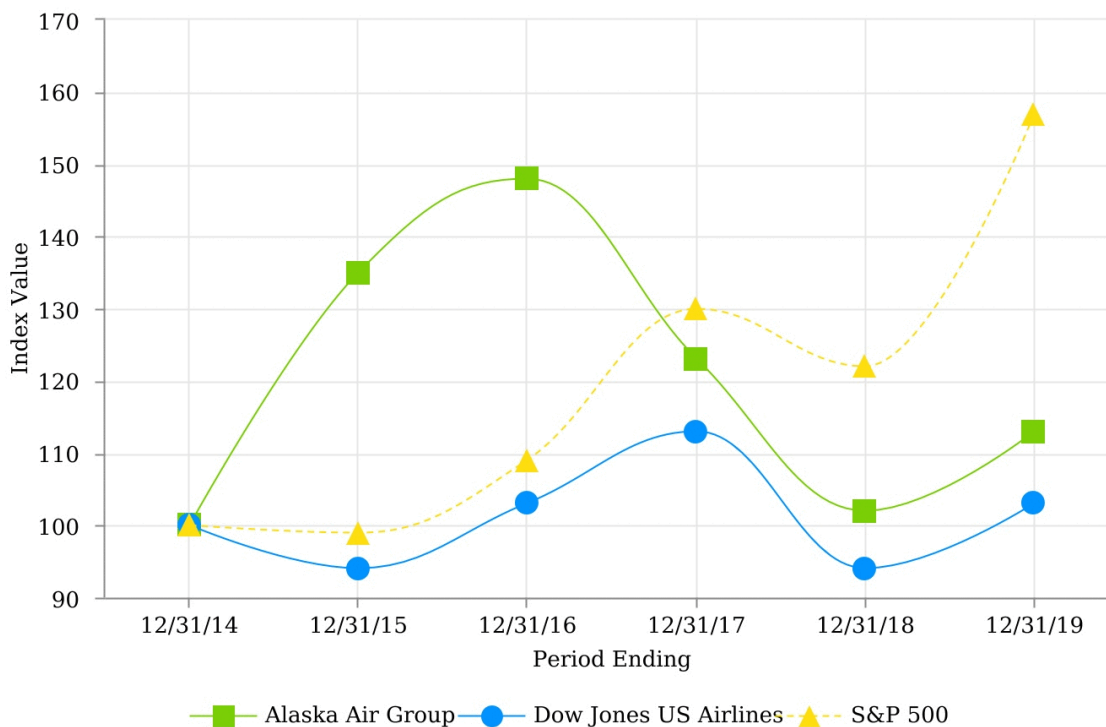
| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares (or units) Purchased as Part of Publicly Announced Plans or Programs | Maximum remaining dollar value of shares that can be purchased under the plan (in millions) |
|---|----------------------------------|------------------------------|---|---|
| October 1, 2019 - October 31, 2019 ^(a) | 117,115 | \$ 66.77 | 117,115 | |
| November 1, 2019 - November 30, 2019 ^(a) | 97,053 | 70.06 | 97,053 | |
| December 1, 2019 - December 31, 2019 ^(a) | 104,633 | 68.23 | 104,633 | |
| Total | 318,801 | \$ 68.25 | 318,801 | \$ 487 |

^(a) Purchased pursuant to the \$1 billion repurchase plan authorized by the Board of Directors in August 2015.

PERFORMANCE GRAPH

The following graph compares our cumulative total stockholder return since December 31, 2014 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, 2014.

Comparison of 5 year Cumulative Total Return



ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

We have recast our financial information for fiscal years 2017 and 2016 to reflect the impacts of the new revenue recognition accounting standard and retirement benefits accounting standard which both became applicable beginning January 1, 2018. Fiscal year 2015 was not recast to reflect the impacts of these standards, and is presented as was previously reported.

| <i>Year Ended December 31 (in millions, except per-share amounts):</i> | 2019 | 2018 | 2017 | 2016 | 2015 |
|--|-------------|-------------|-------------|-------------|-------------|
| CONSOLIDATED OPERATING RESULTS (audited) | | | | | |
| Operating Revenues | \$ 8,781 | \$ 8,264 | \$ 7,894 | \$ 5,925 | \$ 5,598 |
| Operating Expenses | 7,718 | 7,621 | 6,686 | 4,619 | 4,300 |
| Operating Income | 1,063 | 643 | 1,208 | 1,306 | 1,298 |
| Non-operating income (expense), net of interest capitalized ^(a) | (47) | (58) | (49) | 10 | 14 |
| Income before income tax | 1,016 | 585 | 1,159 | 1,316 | 1,312 |
| Net Income | \$ 769 | \$ 437 | \$ 960 | \$ 797 | \$ 848 |
| Average basic shares outstanding | 123,279 | 123,230 | 123,211 | 123,557 | 128,373 |
| Average diluted shares outstanding | 124,289 | 123,975 | 123,854 | 124,389 | 129,372 |
| Basic earnings per share | \$ 6.24 | \$ 3.55 | \$ 7.79 | \$ 6.45 | \$ 6.61 |
| Diluted earnings per share | \$ 6.19 | \$ 3.52 | \$ 7.75 | \$ 6.41 | \$ 6.56 |
| Cash dividends declared per share | \$ 1.40 | \$ 1.28 | \$ 1.20 | \$ 1.10 | \$ 0.80 |
| CONSOLIDATED FINANCIAL POSITION (audited) | | | | | |
| <i>At End of Period (in millions):</i> | | | | | |
| Total assets | \$ 12,993 | \$ 10,912 | \$ 10,746 | \$ 9,968 | \$ 6,530 |
| Long-term debt, including current portion | \$ 1,499 | \$ 2,103 | \$ 2,569 | \$ 2,964 | \$ 683 |
| Shareholders' equity | \$ 4,331 | \$ 3,751 | \$ 3,460 | \$ 2,744 | \$ 2,411 |
| OPERATING STATISTICS (unaudited)^(d) | | | | | |
| Consolidated:^(b) | | | | | |
| Revenue passengers (000) | 46,733 | 45,802 | 44,005 | 34,289 | 31,883 |
| RPMs (000,000) "traffic" | 56,040 | 54,673 | 52,338 | 37,209 | 33,578 |
| ASMs (000,000) "capacity" | 66,654 | 65,335 | 62,072 | 44,135 | 39,914 |
| Load factor | 84.1% | 83.7% | 84.3% | 84.3% | 84.1% |
| Yield | 14.45¢ | 13.96¢ | 13.95¢ | 14.49¢ | 14.27¢ |
| RASM | 13.17¢ | 12.65¢ | 12.72¢ | 13.43¢ | 14.03¢ |
| CASMex ^(c) | 8.70¢ | 8.50¢ | 8.25¢ | 8.32¢ | 8.30¢ |
| Mainline: | | | | | |
| Revenue passengers (000) | 35,530 | 35,603 | 34,510 | 24,838 | 22,869 |
| RPMs (000,000) "traffic" | 50,413 | 49,781 | 48,236 | 33,489 | 30,340 |
| ASMs (000,000) "capacity" | 59,711 | 59,187 | 56,945 | 39,473 | 35,912 |
| Load factor | 84.4% | 84.1% | 84.7% | 84.8% | 84.5% |
| Yield | 13.39¢ | 13.01¢ | 13.02¢ | 13.18¢ | 12.98¢ |
| CASMex ^(c) | 8.00¢ | 7.73¢ | 7.50¢ | 7.39¢ | 7.39¢ |
| Regional ^(b): | | | | | |
| Revenue passengers (000) | 11,203 | 10,199 | 9,495 | 9,452 | 9,015 |
| RPMs (000,000) "traffic" | 5,627 | 4,892 | 4,101 | 3,720 | 3,238 |
| ASMs (000,000) "capacity" | 6,943 | 6,148 | 5,127 | 4,662 | 4,002 |
| Load factor | 81.0% | 79.6% | 80.0% | 79.8% | 80.9% |
| Yield | 23.90¢ | 23.66¢ | 24.96¢ | 26.26¢ | 26.37¢ |

(a) Capitalized interest was \$15 million, \$18 million, \$17 million, \$25 million and \$34 million for 2019, 2018, 2017, 2016 and 2015.

- (b) Includes flights under Capacity Purchase Agreements operated by third-party carriers.
- (c) See reconciliation to the most directly related Generally Accepted Accounting Principles (GAAP) measure in the "Results of Operations" section.
- (d) See "Glossary of Terms" for definitions of the abbreviated terms.

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 our 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 2019 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 our revenues by segment and our expenses from a consolidated perspective for the three years presented in our consolidated financial statements. To the extent material to the understanding of segment profitability, we more fully describe the segment expenses per financial statement line item. Financial and statistical data is also included here. We have recast our financial information to reflect the impact of those standards. This section also includes forward-looking statements regarding our view of 2020.
- *Liquidity and Capital Resources*—an overview of our financial position, analysis of cash flows, sources and uses of cash, contractual obligations and commitments and off-balance sheet arrangements.
- *Critical Accounting Estimates*—a discussion of our accounting estimates that involve significant judgment and uncertainties.

This section of the Form 10-K covers discussion of 2019 and 2018 results, and comparisons between those years. Discussion of 2017 results and comparisons between 2018 and 2017 have been removed from this Form 10-K, and can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

YEAR IN REVIEW

In 2019, we posted our 16th consecutive annual profit on an adjusted basis and an adjusted pretax margin of 12%, which ranks among the top quartile of the industry. Our pretax income was \$1.0 billion, compared to \$585 million in 2018. Our 2019 pretax income on an adjusted basis (a non-GAAP financial measure) was \$1.1 billion, an increase of 43% from the same measure in 2018. Adjusted pretax income for 2019 excludes \$44 million of merger-related costs associated with our acquisition of Virgin America and \$6 million of mark-to-market fuel hedge adjustments.

The increase in adjusted pretax income was driven largely by an increase in operating revenues of \$517 million, and a decrease in fuel expense of \$58 million due to lower fuel prices as compared to the prior year. These improvements were partially offset by an increase in operating expenses, excluding fuel and special items, of \$243 million.

Revenue growth of \$517 million was largely driven by initiatives we launched in late 2018 and early 2019, most notably our new Saver Fare product, and continued network expansion resulting in capacity growth of about 2%.

The \$243 million increase in operating expenses, excluding fuel and special items, was largely due to growth in wages and benefits cost from new collective bargaining agreements and growth in our overall business, requiring an increase in frontline staffing. One of these agreements was a joint collective bargaining agreement with our aircraft mechanics, marking the last of the work groups to integrate from the Virgin America merger. This was a significant achievement and marks 2019 as the year in which we completed substantially all of the integration milestones.

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.

2019 Accomplishments and Highlights

Recognition and Awards

- Ranked "Highest in Customer Satisfaction Among Traditional Carriers" in 2019 by J.D. Power for the 12th year in a row.
- Named "Best U.S. Airline" by Condé Nast Traveler in their 2019 Readers Choice Awards for the second consecutive year.
- Mileage Plan™ ranked first in U.S. News & World Report's list of Best Travel Rewards Programs for the fifth time.
- Ranked as top U.S. airline in Newsweek's 2020 Best Customer Service awards.
- Named "Best Mid-Size Airline" by TripAdvisor in their 2019 Travelers Choice awards.
- Earned top spot for customer satisfaction on the American Customer Satisfaction Index Travel Report for 2018-2019.
- Named "Best Airline" by Kayak in their 2019 Travel Hacker Awards.
- Ranked the best U.S. airline in Money Magazine for the second year in a row.
- Ranked as the top U.S. airline in the Dow Jones Sustainability Index (DJSI) for the third consecutive year.

Our People and Communities

- Ranked among Forbes' 2019 global list for "World's Best Employers" for the fifth year in a row.
- Completed Flight Path, our leader-led program aimed at informing and engaging our employees, bringing over 95% of Air Group employees together to discuss our culture and future.
- Awarded \$163 million in incentive pay for 2019.
- Launched LIFT, Alaska's newly renamed social and environmental impact program, complete with a week of employee volunteer events in eight cities across our network.
- Donated over \$15 million and contributed more than 41,000 volunteer hours to support nonprofits in our local communities, focusing on youth and education, medical (research/transportation) and community outreach.

Shareholder Return

In 2019, we paid cash dividends of \$173 million and repurchased 1,192,820 shares of our common stock for \$75 million under the \$1 billion share repurchase program authorized by our Board of Directors in August 2015. As of December 31, 2019, the Company has repurchased approximately 7.1 million shares for \$513 million under this program.

Since 2007, we have repurchased 62 million shares of common stock for \$1.7 billion for an average price of approximately \$27.89 per share. In 2019, we increased our quarterly dividend 9% from \$0.32 per share to \$0.35 per share, and, subsequent to December 31, 2019, we announced a 7% increase to \$0.375 per share for 2020. Overall, we returned \$248 million to shareholders during 2019. We currently expect to increase capital returns to shareholders in 2020 to approximately \$430 million, of which approximately \$250 million will be from share repurchases.

Labor Update

In July 2019, our aircraft technicians, represented by AMFA, ratified an agreement to integrate Airbus technicians into the collective bargaining agreement with Boeing technicians, as well as extend the contract term by two years. The ratification of the agreement brings all of our labor groups under single collective bargaining agreements, an important milestone less than three years after the merger with Virgin America. In September 2019, Alaska's clerical, office, passenger service, ramp service and stores agents, represented by the IAM, ratified new five-year contracts. Both the IAM and AMFA agreements included signing bonuses and wage rate increases, which were implemented in the third quarter.

Outlook

With the acquisition of Virgin America largely behind us, in 2020 we will shift our focus to executing on our new five-year strategy. Integral to this long-term plan will be achieving 13% to 15% pretax margins and 4% to 6% annual capacity growth over the business cycle. Our revenue initiatives, including our Saver Fare product, provided meaningful revenue improvements in 2019, and are expected to continue to provide incremental revenue in 2020. Benefits from the synergies of the merger also provided positive impacts to our 2019 pretax margin, with the full run-rate expected by 2021. Through cross-fleeting, we were able to optimize the use of our fleet by moving larger-gauge, lower unit cost aircraft into markets with high demand.

In 2020, we anticipate the continuation of these initiatives and synergies will provide an incremental \$125 million of revenue. We also expect additional revenue from initiatives we will be launching throughout 2020. In addition, we will continue our work on notable guest experience enhancement projects which are already underway. By the end of the year, we expect our entire mainline fleet will be equipped with high-speed satellite Wi-Fi, and that the majority of the interiors of our Airbus fleet will be retrofitted to align with the Boeing fleet, allowing for lower unit-costs and incremental premium revenue on Airbus aircraft. Work will also continue with the Port of Seattle to open a state-of-the-art 20-gate North Satellite Concourse at Sea-Tac Airport to be completed in 2021. These improvements, combined with our ongoing rotation of fresh, on-board menu offerings, refreshed aircraft interiors, and optimization of our network, will continue to provide our guests with more options at a significant value.

We expect to grow our combined network capacity in 2020 by approximately 3% to 4%, compared to 2% growth in 2019. Current schedules indicate competitive capacity will increase by roughly one point in the first quarter of 2020. Our capacity guidance is highly dependent on the return to service of the Boeing 737 MAX aircraft. Our current delivery schedule indicates that ten 737 MAX aircraft will be delivered in 2020, three of which were delayed from 2019, plus seven originally contracted for delivery in 2020. Should the grounding of the aircraft further delay those ten deliveries beyond our current expectations, our capacity growth could be negatively impacted.

Given another year of slower growth and increased cost pressure from higher wages, airport costs and maintenance costs, we expect unit costs to increase approximately 2% in 2020. This expectation excludes the impacts of any new labor agreements that might be reached during the year. In order to reach our long-term margin goals of 13% to 15%, we will mitigate cost pressures through a continued focus on higher productivity and lower overhead. We believe that our product, our operation, our engaged employees, our award-winning service, and our competitive Mileage Plan™, combined with our strong balance sheet and focus on low costs, give us the ability to compete successfully in the markets we serve and generate meaningful profit margins.

RESULTS OF OPERATIONS

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

We believe disclosure of earnings excluding the impact of merger-related costs, mark-to-market gains or losses or other individual special revenues or expenses is useful information to investors because:

- By excluding fuel expense and certain special items (including merger-related and other costs) from our unit metrics, we believe that we have better visibility into the results of operations and our non-fuel cost initiatives. Our industry is highly competitive and is characterized by high fixed costs, so even a small reduction in non-fuel operating costs can lead to 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 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, such as merger-related costs, 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.
- Adjusted income before income tax and CASM excluding fuel (and other items as specified in our plan documents) are important metrics for the employee incentive plan, which covers the majority of Air Group employees.

- CASM excluding fuel and certain special items is a measure commonly used by industry analysts and we believe it is an important metric 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 merger-related costs and mark-to-market hedging adjustments, 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.

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.

2019 COMPARED WITH 2018

Our consolidated net income for 2019 was \$769 million, or \$6.19 per diluted share, compared to net income of \$437 million, or \$3.52 per diluted share, in 2018.

Excluding the impact of merger-related costs and mark-to-market fuel hedge adjustments, our adjusted consolidated net income for 2019 was \$798 million, or \$6.42 per diluted share, compared to an adjusted consolidated net income of \$554 million, or \$4.46 per share, in 2018. The following table reconciles our adjusted net income and earnings per diluted share (EPS) during the full year 2019 and 2018 to amounts as reported in accordance with GAAP.

| <i>(in millions, except per-share amounts)</i> | Twelve Months Ended December 31, | | | |
|---|----------------------------------|-------------|---------|-------------|
| | 2019 | | 2018 | |
| | Dollars | Diluted EPS | Dollars | Diluted EPS |
| Reported GAAP net income and diluted EPS | \$ 769 | \$ 6.19 | \$ 437 | \$ 3.52 |
| Mark-to-market fuel hedge adjustments | (6) | (0.05) | 22 | 0.18 |
| Special items - merger-related costs | 44 | 0.35 | 87 | 0.70 |
| Special items - other ^(a) | — | — | 45 | 0.36 |
| Income tax effect on special items and fuel hedge adjustments | (9) | (0.07) | (37) | (0.30) |
| Non-GAAP adjusted net income and diluted EPS | \$ 798 | \$ 6.42 | \$ 554 | \$ 4.46 |

(a) Special items - other relates to the employee tax reform bonus awarded in January 2018 and a \$20 million contract termination fee incurred in December 2018.

CASM is summarized below:

| | Twelve Months Ended December 31, | | |
|---|----------------------------------|---------------|----------|
| | 2019 | 2018 | % Change |
| Consolidated: | | | |
| Total CASM | 11.58 ¢ | 11.66 ¢ | (0.7)% |
| Less the following components: | | | |
| Aircraft fuel, including hedging gains and losses | 2.82 | 2.96 | (4.7)% |
| Special items - merger-related costs | 0.06 | 0.13 | (53.8)% |
| Special items - other ^(a) | — | 0.07 | NM |
| CASM, excluding fuel and special items | <u>8.70 ¢</u> | <u>8.50 ¢</u> | 2.3% |
| Mainline: | | | |
| Total CASM | 10.73 ¢ | 10.78 ¢ | (0.5)% |
| Less the following components: | | | |
| Aircraft fuel, including hedging gains and losses | 2.65 | 2.83 | (6.4)% |
| Special items - merger-related costs ^(a) | 0.08 | 0.14 | (42.9)% |
| Special items - other ^(a) | — | 0.08 | NM |
| CASM, excluding fuel and special items | <u>8.00 ¢</u> | <u>7.73 ¢</u> | 3.5% |

(a) Special items - other relates to the employee tax reform bonus awarded in January 2018 and a \$20 million contract termination fee incurred in December 2018.

OPERATING STATISTICS SUMMARY (unaudited)
Alaska Air Group, Inc.

Below are operating statistics we use to measure performance. Certain historical information has been adjusted to reflect the adoption of new accounting standards. We often refer to unit revenues and adjusted unit costs, which are non-GAAP measures.

| | Twelve Months Ended December 31, | | | | |
|---|----------------------------------|---------|---------|---------|-----------|
| | 2019 | 2018 | Change | 2017 | Change |
| Consolidated Operating Statistics:^(a) | | | | | |
| Revenue passengers (000) | 46,733 | 45,802 | 2.0% | 44,005 | 4.1% |
| RPMs (000,000) "traffic" | 56,040 | 54,673 | 2.5% | 52,338 | 4.5% |
| ASMs (000,000) "capacity" | 66,654 | 65,335 | 2.0% | 62,072 | 5.3% |
| Load factor | 84.1 | 83.7% | 0.4 pts | 84.3% | (0.6) pts |
| Yield ^(d) | 14.45¢ | 13.96¢ | 3.5% | 13.95¢ | 0.1% |
| RASM ^(d) | 13.17¢ | 12.65¢ | 4.2% | 12.72¢ | (0.6)% |
| CASM excluding fuel and special items ^{(b)(d)} | 8.70¢ | 8.50¢ | 2.3% | 8.25¢ | 3.0% |
| Economic fuel cost per gallon ^(b) | \$2.19 | \$2.28 | (3.9)% | \$1.82 | 25.3% |
| Fuel gallons (000,000) | 862 | 839 | 2.7% | 797 | 5.3% |
| ASM's per gallon | 77.3 | 77.9 | (0.8)% | 77.9 | —% |
| Average number of full-time equivalent employees (FTEs) | 22,126 | 21,641 | 2.2% | 20,183 | 7.2% |
| Employee productivity (PAX/FTEs/months) | 176.0 | 176.4 | (0.2)% | 181.7 | (2.9)% |
| Mainline Operating Statistics: | | | | | |
| Revenue passengers (000) | 35,530 | 35,603 | (0.2)% | 34,510 | 3.2% |
| RPMs (000,000) "traffic" | 50,413 | 49,781 | 1.3% | 48,236 | 3.2% |
| ASMs (000,000) "capacity" | 59,711 | 59,187 | 0.9% | 56,945 | 3.9% |
| Load factor | 84.4 | 84.1% | 0.3 pts | 84.7% | (0.6) pts |
| Yield ^(d) | 13.39¢ | 13.01¢ | 2.9% | 13.02¢ | (0.1)% |
| RASM ^(d) | 12.36¢ | 11.93¢ | 3.6% | 12.00¢ | (0.6)% |
| CASM excluding fuel and special items ^{(b)(d)} | 8.00¢ | 7.73¢ | 3.5% | 7.50¢ | 3.1% |
| Economic fuel cost per gallon ^(b) | \$2.17 | \$2.27 | (4.4)% | \$1.82 | 24.7% |
| Fuel gallons (000,000) | 731 | 727 | 0.6% | 706 | 3.0% |
| ASM's per gallon | 81.7 | 81.4 | 0.4% | 80.7 | 0.9% |
| Average number of FTEs | 16,642 | 16,353 | 1.8% | 15,653 | 4.5% |
| Aircraft utilization | 10.9 | 11.2 | (2.7)% | 11.2 | —% |
| Average aircraft stage length | 1,299 | 1,298 | 0.1% | 1,301 | (0.2)% |
| Mainline operating fleet at period-end | 237 a/c | 233 a/c | 4 a/c | 221 a/c | 12 a/c |
| Regional Operating Statistics:^(c) | | | | | |
| Revenue passengers (000) | 11,203 | 10,199 | 9.8% | 9,495 | 7.4% |
| RPMs (000,000) "traffic" | 5,627 | 4,892 | 15.0% | 4,101 | 19.3% |
| ASMs (000,000) "capacity" | 6,943 | 6,148 | 12.9% | 5,127 | 19.9% |
| Load factor | 81.0 | 79.6% | 1.4 pts | 80.0% | (0.4) pts |
| Yield ^(d) | 23.90¢ | 23.66¢ | 1.0% | 24.96¢ | (5.2)% |

^(a) Except for FTEs, data includes information related to third-party regional capacity purchase flying arrangements.

^(b) See reconciliation of this non-GAAP measure to the most directly related GAAP measure in the accompanying pages.

^(c) Data presented includes information related to flights operated by Horizon and third-party carriers.

^(d) Information for 2017 has been adjusted to reflect the adoption of new accounting standards.

OPERATING REVENUES

Total operating revenues increased \$517 million, or 6%, during 2019 compared to the same period in 2018. The changes are summarized in the following table:

| (in millions) | Twelve Months Ended December 31, | | |
|----------------------------|----------------------------------|----------|----------|
| | 2019 | 2018 | % Change |
| Passenger revenue | \$ 8,095 | \$ 7,631 | 6.1 % |
| Mileage Plan other revenue | 465 | 434 | 7.1 % |
| Cargo and other | 221 | 199 | 11.1 % |
| Total operating revenues | \$ 8,781 | \$ 8,264 | 6.3 % |

Passenger Revenue

On a consolidated basis, passenger revenue for 2019 increased by \$464 million, or 6%, on a 2% increase in capacity, and a 4.2% increase in unit revenues. The capacity increase was driven by the continued expansion of our network and fleet growth over the past year. Unit revenues increased largely due to our current year revenue initiatives, including our Saver Fare product, implemented as a part of a broader plan to drive revenue growth, and the realization of synergies from our acquisition of Virgin America.

Mileage Plan other revenue

On a consolidated basis, Mileage Plan other revenue increased \$31 million, or 7%, as compared to 2018, primarily due to increased miles purchased by our affinity card partner consistent with the overall growth in cardholders.

Cargo and Other Revenue

On a consolidated basis, Cargo and other revenue increased \$22 million, or 11%, from 2018. The increase is primarily attributable to increased freight and mail volumes from our three freighters as a result of the annualization of new contracts entered into late in 2018 and revenue from our subleased slots at LaGuardia and Reagan National airports.

OPERATING EXPENSES

Total operating expenses increased \$97 million, or 1%, compared to 2018. We consider it useful to summarize operating expenses as follows, which is consistent with the way expenses are reported internally and evaluated by management:

| (in millions) | Twelve Months Ended December 31, | | |
|--------------------------------------|----------------------------------|----------|----------|
| | 2019 | 2018 | % Change |
| Fuel expense | \$ 1,878 | \$ 1,936 | (3.0)% |
| Non-fuel expenses | 5,796 | 5,553 | 4.4 % |
| Special items - merger-related costs | 44 | 87 | (49.4)% |
| Special items - other | — | 45 | NM |
| Total Operating Expenses | \$ 7,718 | \$ 7,621 | 1.3 % |

Significant operating expense variances from 2018 are more fully described below.

Aircraft Fuel

Aircraft fuel expense includes both *raw fuel expense* (as defined below) and 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. Aircraft fuel expense can be 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.

Aircraft fuel expense decreased \$58 million, or 3%, compared to 2018. The elements of the change are illustrated in the following table:

| <i>(in millions, except for per gallon amounts)</i> | Twelve Months Ended December 31, | | | |
|---|----------------------------------|----------|----------|----------|
| | 2019 | | 2018 | |
| | Dollars | Cost/Gal | Dollars | Cost/Gal |
| Raw or "into-plane" fuel cost | \$ 1,868 | \$ 2.17 | \$ 1,938 | \$ 2.31 |
| (Gain)/loss on settled hedges | 16 | 0.02 | (24) | (0.03) |
| Consolidated economic fuel expense | \$ 1,884 | \$ 2.19 | \$ 1,914 | \$ 2.28 |
| Mark-to-market fuel hedge adjustments | (6) | (0.01) | 22 | 0.03 |
| GAAP fuel expense | \$ 1,878 | \$ 2.18 | \$ 1,936 | \$ 2.31 |
| Fuel gallons | 862 | | 839 | |

Raw fuel expense per gallon decreased 6% due to lower West Coast jet fuel prices. West Coast jet fuel prices are impacted by both the price of crude oil, as well as the refining costs associated with the conversion of crude oil to jet fuel. The decrease in raw fuel price per gallon during 2019 was driven by a 12% decrease in crude oil prices, partially offset by a 9% increase in refining margins, as compared to the prior year. Fuel gallons consumed increased by 23 million, or 3%, consistent with the increase in capacity of 2%, and a 3% increase in block hours.

We also evaluate economic fuel expense, which we define as raw fuel expense adjusted for the cash we receive from 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 have 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.

Losses recognized for hedges that settled during the year were \$16 million in 2019, compared to gains of \$24 million in 2018. These amounts represent cash paid for premium expense, offset by any cash received from those hedges at settlement.

As of the date of this filing, we expect our economic fuel price per gallon to increase approximately 4% in the first quarter of 2020, as compared to the first quarter of 2019 due to increasing crude oil prices, offset by a slight decrease in refining margins. As both oil prices and refining margins are volatile, we are unable to forecast the full-year cost with any certainty.

Wages and Benefits

Wages and benefits increased during 2019 by \$180 million, or 8%, compared to 2018. The primary components of wages and benefits are shown in the following table:

| <i>(in millions)</i> | Twelve Months Ended December 31, | | |
|---------------------------------|----------------------------------|----------|----------|
| | 2019 | 2018 | % Change |
| Wages | \$ 1,760 | \$ 1,658 | 6.2 % |
| Pension - Defined benefit plans | 42 | 48 | (12.5)% |
| Defined contribution plans | 132 | 126 | 4.8 % |
| Medical and other benefits | 311 | 245 | 26.9 % |
| Payroll taxes | 125 | 113 | 10.6 % |
| Total wages and benefits | \$ 2,370 | \$ 2,190 | 8.2 % |

Wages and payroll taxes increased by a combined \$114 million on a 2.2% increase in FTEs. The increase in FTEs is attributable to the growth in our business. Additionally, the increase in wages is driven by the recognition of approximately \$24 million in one-time costs following the ratification of the AMFA and IAM contracts in the third quarter, as well as the impact of increased wage rates for our labor groups as compared to the prior-year period.

Medical and other benefits expense increased \$66 million, or 27%, primarily due to FTE growth, rising medical costs, a greater occurrence of high-dollar value claims in 2019 as compared to the prior year, and increases in the obligation for our pilots long-term disability plan.

We expect wages and benefits expense to be higher in 2020 compared to 2019 on an approximate 3% increase in FTEs. Our guidance does not include the impact of any future agreements we may reach with represented work groups in 2020, most notably our mainline pilots whose contract becomes amendable in April 2020.

Variable Incentive Pay

Variable incentive pay expense increased to \$163 million in 2019 from \$147 million in 2018 due to a higher wage base upon which the achievement percentage is applied, as well as a greater achievement of our stated goals, as compared to the prior year.

Aircraft Maintenance

Aircraft maintenance costs increased by \$2 million compared to 2018. Although not a significant increase overall, core maintenance costs were higher resulting from a larger volume of airframe and engine maintenance checks as compared to the prior year, particularly on our Airbus fleet. This was partially offset by lower costs associated with our leased Airbus aircraft.

We expect aircraft maintenance expense to increase 17% to 19% in 2020 due to increased volume of engine maintenance checks on our Airbus and B737-800 fleets, as well as increased costs associated with the return of certain leased Airbus aircraft.

Aircraft Rent

Aircraft rent expense increased \$16 million, or 5%, compared to 2018, primarily due to the addition of two A321neos to our Mainline fleet and the annualization of rent on our leased E175s under the CPA agreement with SkyWest.

We expect aircraft rent to be flat in 2020.

Landing Fees and Other Rentals

Landing fees and other rental expenses increased \$32 million, or 6%, compared to 2018, primarily driven by a 2% increase in capacity and rate increases at many of our hub airports.

We expect landing fees and other rental expense to grow 9% to 12% in 2020 as we continue to add capacity to our network. We also expect rate increases at many airports we serve, specifically our hubs, as significant capital programs are underway and will be included in our lease rates.

Selling Expenses

Selling expenses decreased by \$13 million, or 4%, compared to 2018 due to improvements in our credit card rates, as well as decreased spending on advertising as compared to the prior year.

We expect selling expense to decrease slightly in 2020, due primarily to ongoing reductions in overall advertising and sponsorship spend, and an expected shift in distribution to lower-cost channels.

Depreciation and Amortization

Depreciation and amortization expenses increased by \$25 million, or 6%, compared to 2018, primarily due to the addition of four owned B737-900ERs and four owned E175s to our fleet since December 31, 2018.

We expect depreciation and amortization expense to increase 4% to 6% in 2020, primarily due to the full year impact of depreciation on aircraft delivered in 2019 and the impact of 737 MAX aircraft scheduled for delivery in 2020.

Third-party Regional Carrier Expense

Third-party regional carrier expense, which represents payments made to SkyWest and PenAir under our CPA agreements, increased \$12 million, or 8%, in 2019 compared to 2018. The increase is primarily due to a 3.3% increase in capacity flown by SkyWest as compared to the prior year and higher CPA rates.

We expect third-party regional carrier expense to be flat in 2020 as there is no expected growth in the number of aircraft to be operated by SkyWest.

Special Items - Merger-Related Costs

We recorded \$44 million of merger-related costs in 2019 associated with our ongoing integration of former Virgin America operations, compared to \$87 million in 2018. Costs incurred in 2019 consisted primarily of expenses associated with Airbus flight attendant and pilot vacation balances, which were subject to a one-time true-up in accordance with the integrated labor agreements, as well as certain technology integration costs. We expect to incur merger-related costs in 2020, although at a lesser rate.

Consolidated Non-operating Income (Expense)

During 2019 we recorded net non-operating expense of \$47 million, compared to \$58 million in 2018. The decrease is primarily due to lower interest expense as compared to 2018 as a result of an overall reduction in our debt balance and a reduction in average interest rates.

ADDITIONAL SEGMENT INFORMATION

Refer to Note 13 of the consolidated financial statements for a detailed description of each segment. Below is a summary of each segment's profitability.

Mainline

Mainline adjusted pretax profit was \$993 million in 2019 compared to \$809 million in 2018. The \$184 million increase in pretax profit was primarily driven by a \$318 million increase in Mainline operating revenue and a \$63 million decrease in Mainline fuel expense. These increases were partially offset by a \$201 million increase in Mainline non-fuel operating expenses.

Mainline revenue increased primarily due to a 3% increase in yields and a slight increase in load factor as compared to the prior year. Lower raw fuel prices, offset by an increase in gallons consumed, drove the decrease in Mainline fuel expense. Non-fuel operating expense increased due to a \$24 million signing bonus and higher wage rates from new contracts with our IAM and AMFA employees, as well as increased aircraft ownership and maintenance costs.

Regional

Our Regional operations generated a pretax profit of \$2 million in 2019 compared to a pretax loss of \$100 million in 2018. The improvement was primarily attributable to a \$197 million increase in operating revenues, partially offset by \$73 million higher non-fuel operating expense and \$33 million increase in fuel costs. Increased revenues and non-fuel operating expenses is primarily driven by the 13% increase in capacity.

Horizon

Horizon achieved a pretax profit of \$38 million in 2019 compared to \$27 million in 2018. The change was primarily driven by a 22% increase in capacity growth attributable to four E175 aircraft added to Horizon's fleet over the past year and improved cost management through better productivity and improved operational performance.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are:

- Our existing cash and marketable securities balance of \$1.5 billion, and our expected cash from operations;

- Our 133 unencumbered aircraft in the operating fleet as of December 31, 2019, that could be financed, if necessary; and
- Our combined bank line-of-credit facilities, with no outstanding borrowings, of \$400 million. Information about these facilities can be found in Note 5 to the consolidated financial statements.

In 2019, we took delivery of four owned B737-900ER and four owned E175 aircraft, and made net debt payments totaling \$608 million, undertaken as part of our broader plan of reducing balance sheet leverage and lowering interest expense. As part of this overall reduction plan, as of December 31, 2019, we have paid off approximately 75% of the debt sourced to fund the Virgin America acquisition. We also continued to return capital to our shareholders by paying dividends totaling \$173 million and repurchasing \$75 million of our common stock. Because of our strong balance sheet and financial performance, we are one of only three airlines in the U.S. with investment grade credit ratings.

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 and meet our debt payment obligations for the foreseeable future.

In our cash and marketable securities portfolio, we invest only in securities that meet our primary investment strategy of maintaining and securing investment principal. The portfolio is managed by reputable firms that adhere to our investment policy that sets forth investment objectives, approved and prohibited investments, and duration and credit quality guidelines. Our policy, and the portfolio managers, are continually reviewed to ensure that the investments are aligned with our strategy.

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

| <i>(in millions)</i> | December 31, 2019 | December 31, 2018 | Change |
|---|-------------------|-------------------|---------|
| Cash and marketable securities | \$1,521 | \$1,236 | \$285 |
| Cash, marketable securities, and unused lines of credit as a percentage of trailing twelve months revenue | 22% | 20% | 2 pts |
| Long-term debt, net of current portion | \$1,264 | \$1,617 | \$(353) |
| Shareholders' equity | \$4,331 | \$3,751 | \$580 |

Debt-to-capitalization, adjusted for operating leases

| <i>(in millions)</i> | December 31, 2019 | December 31, 2018 | Change |
|---|-------------------|-------------------|--------|
| Long-term debt, net of current portion | \$ 1,264 | \$ 1,617 | (22)% |
| Capitalized operating leases ^(a) | 1,708 | 1,768 | (a) |
| Adjusted debt | \$ 2,972 | \$ 3,385 | |
| Shareholders' equity | 4,331 | 3,751 | 15% |
| Total invested capital | 7,303 | 7,136 | 2% |
| Debt-to-capitalization, including operating leases | 41% | 47% | |

(a) Following the adoption of the new lease accounting standard on January 1, 2019, this represents the total capitalized Operating lease liability, whereas prior year periods were calculated utilizing the present value of aircraft lease payments. This change had no meaningful impact to the ratio.

Net adjusted debt to earnings before interest, taxes, depreciation, amortization, special items and rent

| <i>(in millions)</i> | December 31, 2019 | |
|--------------------------------------|--------------------------|--------------|
| Adjusted debt | \$ | 2,972 |
| Current portion of long-term debt | | 235 |
| Total adjusted debt | | 3,207 |
| Less: Cash and marketable securities | | (1,521) |
| Net adjusted debt | \$ | 1,686 |

| <i>(in millions)</i> | Year-ended December 31, 2019 | |
|---------------------------------------|-------------------------------------|--------------|
| GAAP Operating Income | \$ | 1,063 |
| Adjusted for: | | |
| Special items | | 44 |
| Mark-to-market fuel hedge adjustments | | (6) |
| Depreciation and amortization | | 423 |
| Aircraft rent | | 331 |
| EBITDAR | \$ | 1,855 |

Net adjusted debt to EBITDAR 0.9x

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*

Net cash provided by operating activities was \$1.7 billion in 2019 compared to \$1.2 billion in 2018. The increase of \$527 million is primarily due to a \$332 million increase in our net income and an increase in advance ticket sales on an expected increase in first quarter capacity as compared to the prior year. These increases were partially offset by a \$65 million voluntary pension contribution.

We typically generate positive cash flows from operations, and expect to use that cash flow to buy aircraft and capital equipment, to make debt payments, and to return capital to shareholders.

Cash Used in Investing Activities

Cash used in investing activities was \$791 million during 2019, compared to \$631 million in 2018. Our capital expenditures were \$696 million, or \$264 million lower than in 2018, primarily driven by lower cash outlays for deliveries of and advance deposits on aircraft in 2019 as compared to the same period of 2018. Our net purchases of marketable securities were \$136 million in 2019, compared to net sales of \$282 million in 2018. The shift to net purchases is primarily driven by stronger operating cash flows as compared to 2018. Internally, we analyze and manage our cash and marketable securities balance in the aggregate.

Cash Used in Financing Activities

Cash used in financing activities was \$813 million during 2019, compared to cash used in financing activities of \$647 million in 2018. During the year, we made debt payments of \$1.1 billion, repurchased \$75 million of our common stock and paid cash dividends of \$173 million. These payments were partially offset by the receipt of funds from new secured debt financing of \$450 million in 2019. This compares to our activity in 2018, which consisted of net debt payments of \$468 million, repurchases of \$50 million of our common stock and cash dividend payments of \$158 million.

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

Bank Lines of Credit

We have three credit facilities with availability totaling \$516 million, including one \$250 million credit facility, one \$150 million credit facility, and one \$116 million credit facility. We have secured letters of credit against the \$116 million facility, but have no plans to borrow using either of the two remaining facilities.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Aircraft Purchase and Lease Commitments

As of December 31, 2019, we have firm orders to purchase 35 aircraft. We also have cancelable purchase commitments for 30 Airbus A320neo aircraft with deliveries from 2023 through 2025. We could incur a loss of pre-delivery payments and credits as a cancellation fee. We also have options to acquire up to 37 additional 737 MAX aircraft with deliveries from 2021 through 2024 and 30 E175 aircraft with deliveries from 2021 to 2023. In addition to the 32 E175 aircraft currently operated by SkyWest in our regional fleet, we have options in future periods to add regional capacity by having SkyWest operate up to eight more E175 aircraft.

We expect capital expenditures to be approximately \$750 million in 2020, pending 737 MAX deliveries and any decision made for future aircraft orders. We have included in the table below the three undelivered aircraft from 2019 in our 2020 delivery schedule. The total of ten deliveries is subject to change based on the ongoing FAA grounding of the aircraft.

The following table summarizes our contractual fleet count by year, as of February 12, 2020:

| Aircraft | Actual Fleet Count | | | Contractual Deliveries ^(a) | | |
|---|--------------------|--------------|--------------|---------------------------------------|--------------|--------------|
| | Dec 31, 2018 | Dec 31, 2019 | 2020 Changes | Dec 31, 2020 | 2021 Changes | Dec 31, 2021 |
| B737 Freighters | 3 | 3 | — | 3 | — | 3 |
| B737 Passenger Aircraft ^(c) | 159 | 163 | 10 | 173 | 7 | 180 |
| Airbus Passenger Aircraft | 71 | 71 | (1) | 70 | (9) | 61 |
| Total Mainline Fleet | 233 | 237 | 9 | 246 | (2) | 244 |
| Q400 operated by Horizon ^(b) | 39 | 33 | (1) | 32 | — | 32 |
| E175 operated by Horizon ^(b) | 26 | 30 | — | 30 | — | 30 |
| E175 operated by third party ^(b) | 32 | 32 | — | 32 | — | 32 |
| Total Regional Fleet | 97 | 95 | (1) | 94 | — | 94 |
| Total | 330 | 332 | 8 | 340 | (2) | 338 |

^(a) The expected fleet counts at December 31, 2020 and 2021 reflect contractual lease returns, and is subject to change pending our long-term fleet decisions and strategies for future acquisition of aircraft.

^(b) Aircraft are either owned or leased by Horizon or operated under capacity purchase agreement with a third party.

^(c) All three of our Boeing 737 MAX9 aircraft that were originally scheduled for delivery in 2019 have been shifted to 2020 in light of the MAX grounding.

For future firm orders and option exercises, we may finance the aircraft through cash from operations, long-term debt, or lease arrangements.

Future Fuel Hedge Positions

All of our future oil positions are call options, which are designed to effectively cap the cost of the crude oil component of our jet fuel purchases. With call options, we are hedged against volatile crude oil price increases; and, during a period of decline in crude oil prices, we only forfeit cash previously paid for hedge premiums. Our crude oil positions are as follows:

| | Approximate % of Expected Fuel Requirements | Weighted-Average Crude Oil Price per Barrel | Average Premium Cost per Barrel |
|-----------------------|---|---|---------------------------------|
| First Quarter 2020 | 50% | \$70 | \$2 |
| Second Quarter 2020 | 50% | \$67 | \$2 |
| Third Quarter 2020 | 40% | \$67 | \$2 |
| Fourth Quarter 2020 | 30% | \$65 | \$2 |
| Full Year 2020 | 42% | \$68 | \$2 |
| First Quarter 2021 | 20% | \$63 | \$2 |
| Second Quarter 2021 | 10% | \$64 | \$2 |
| Full Year 2021 | 7% | \$63 | \$2 |

Contractual Obligations

The following table provides a summary of our obligations as of December 31, 2019. For agreements with variable terms, amounts included reflect our minimum obligations.

| (in millions) | 2020 | 2021 | 2022 | 2023 | 2024 | Beyond | Total |
|--|-----------------|-----------------|-----------------|---------------|---------------|-----------------|-----------------|
| Current and long-term debt obligations | \$ 235 | \$ 281 | \$ 243 | \$ 173 | \$ 153 | \$ 420 | \$ 1,505 |
| Aircraft leases commitments | 324 | 295 | 269 | 212 | 160 | 660 | 1,920 |
| Facility lease commitments | 11 | 8 | 7 | 7 | 7 | 85 | 125 |
| Aircraft maintenance deposits | 73 | 62 | 51 | 26 | 6 | 2 | 220 |
| Aircraft purchase commitments | 531 | 487 | 347 | 206 | 31 | 26 | 1,628 |
| Interest obligations ^(a) | 43 | 36 | 27 | 21 | 16 | 25 | 168 |
| Other obligations ^(b) | 152 | 173 | 181 | 186 | 192 | 885 | 1,769 |
| Total | <u>\$ 1,369</u> | <u>\$ 1,342</u> | <u>\$ 1,125</u> | <u>\$ 831</u> | <u>\$ 565</u> | <u>\$ 2,103</u> | <u>\$ 7,335</u> |

^(a) For variable-rate debt, future obligations are shown above using interest rates forecast as of December 31, 2019.

^(b) Primarily comprised of non-aircraft lease costs associated with capacity purchase agreements.

Defined Benefit Pensions

The table above excludes contributions to our various pension plans, for which there are no minimum required contributions given the funded status of the plans. The unfunded liability for our qualified defined-benefit pension plans was \$363 million at December 31, 2019, compared to a \$367 million unfunded position at December 31, 2018. This results in an 86% funded status on a projected benefit obligation basis compared to 84% funded as of December 31, 2018. We made a voluntary contribution of \$65 million to the plans in 2019.

Credit Card Agreements

We have agreements with a number of credit card companies to process the sale of tickets and other services. Under these agreements, there are material adverse change clauses that, if triggered, could result in the credit card companies holding back a reserve from our credit card receivables. Under one such agreement, we could be required to maintain a reserve if our credit rating is downgraded to or below a rating specified by the agreement or our cash and marketable securities balance fell below \$500 million. Under another such agreement, we could be required to maintain a reserve if our cash and marketable securities balance fell below \$500 million. We are not currently required to maintain any reserve under these agreements, but if we were, our financial position and liquidity could be materially harmed.

Deferred Income Taxes

For federal income tax purposes, the majority of our assets are fully depreciated over a seven-year life using an accelerated depreciation method or bonus depreciation, if available. For financial reporting purposes, the majority of our assets are depreciated over 15 to 25 years to an estimated salvage value using the straight-line basis. This difference has created a significant deferred tax liability. At some point in the future the depreciation basis will reverse, potentially resulting in an increase in income taxes paid.

While it is possible that we could have material cash obligations for this deferred liability at some point in the future, we cannot estimate the timing of long-term cash flows with reasonable accuracy. Taxable income and cash taxes payable in the short-term are impacted by many items, including the amount of book income generated (which can be volatile depending on revenue and fuel prices), usage of net operating losses, whether bonus depreciation provisions are available, any future tax reform efforts at the federal level, as well as other legislative changes that are beyond our control.

In 2019, we made tax payments, net of refunds, totaling \$31 million, and had an effective tax rate of 24.3%. We believe that we will have the liquidity available to make our future tax payments.

CRITICAL ACCOUNTING ESTIMATES

The discussion and analysis of our financial position and results of operations in this MD&A are based upon our consolidated financial statements. The preparation of these financial statements requires us to make estimates and judgments that affect our financial position and results of operations. See Note 1 to the consolidated financial statements for a description of our significant accounting policies.

Critical accounting estimates are defined as those that reflect significant management judgment and uncertainties and that potentially may lead to materially different results under varying assumptions and conditions. Management has identified the following critical accounting estimates and has discussed the development, selection and disclosure of these policies with our audit committee.

FREQUENT FLYER PROGRAMS

Alaska's Mileage Plan™ loyalty program awards mileage credits to members who fly on our airlines and our airline partners, referred to as flown miles. We also sell services, including miles for transportation, Companion Fare™ certificates, bag fee waivers, and access to our brand and customer lists to major banks that offer Alaska co-brand credit cards. To a lesser extent, miles for transportation are also sold to other non-airline partners, such as hotels, and car rental agencies. The outstanding miles may be redeemed for travel on our airlines or eligible airline partners, and for non-airline products such as hotels. As long as the Mileage Plan™ is in existence, we have an obligation to provide future travel.

Mileage credits and the various other services we sell under our loyalty program represent performance obligations that are part of a multiple deliverable revenue arrangement. Accounting guidance requires that we use a relative standalone selling price allocation to allocate consideration received to the material performance obligations in these contracts. Our relative standalone selling price allocation models are refreshed when contracts originate or are materially modified. We also update our model annually based on observed volumes.

At December 31, 2019, we had approximately 262 billion miles outstanding, resulting in an aggregate deferred revenue balance of \$2.0 billion. The deferred revenue resulting from our relative selling price allocations requires significant management judgment. There are uncertainties inherent in these estimates.

Therefore, different assumptions could affect the amount and/or timing of revenue recognition or expenses. The most significant assumptions are described below.

1. *The rate at which we defer sales proceeds related to services sold:*

We estimate the standalone selling price for each performance obligation, including mileage credits, by considering multiple inputs and methods, including but not limited to, the estimated selling price of comparable travel, discounted cash flows, brand value, published selling prices, number of miles awarded, and the number of miles redeemed. We estimate the selling prices and volumes over the terms of the agreements in order to determine the allocation of proceeds to each of the multiple deliverables.

2. *The number of miles that will not be redeemed for travel (breakage):*

We estimate how many miles will be used per award. For example, our members may redeem mileage credits for award travel to various locations or choose between a highly restricted award and an unrestricted award. Our estimates are based on the current requirements in our Mileage Plan program™ and historical award redemption patterns.

We regularly review significant Mileage Plan™ assumptions and change our assumptions if facts and circumstances indicate that a change is necessary. Any such change in assumptions could have a significant effect on our financial position and results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We have interest-rate risk on our variable-rate debt obligations and our available-for-sale marketable investment portfolio, and commodity-price risk in jet fuel required to operate our aircraft fleet. We purchase the majority of our jet fuel at prevailing market prices and seek to manage market risk through execution of our hedging strategy and other means. We have market-sensitive instruments in the form of fixed-rate debt instruments and financial derivative instruments used to hedge our exposure to jet fuel price increases and interest-rate increases. We do not purchase or hold any derivative financial instruments for trading purposes.

Aircraft Fuel

Currently, our fuel-hedging portfolio consists of crude oil call options. Call options effectively cap our pricing for the crude oil component of jet fuel, limiting our exposure to increasing fuel prices for about half of our planned fuel consumption. With call options, we are hedged against volatile crude oil price increases, and, during a period of decline in crude oil prices, we only forfeit cash paid for hedge premiums. We believe there is risk in not hedging against fuel price increases. We estimate that a hypothetical 10% increase or decrease in the forward curve for crude oil prices as of December 31, 2019 would change the fair value of our crude oil hedge portfolio to approximately \$3 million or \$33 million.

Our portfolio value of fuel hedge contracts was \$11 million at December 31, 2019 compared to a portfolio value of \$4 million at December 31, 2018. We did not have any collateral held by counterparties to these agreements as of December 31, 2019.

We continue to believe that our fuel hedge program is an important part of our strategy to reduce our exposure to volatile fuel prices. We expect to enter into these types of contracts prospectively, although significant changes in market conditions could affect our decisions. For more discussion, see Note 3 to our consolidated financial statements.

Interest Rates

We have exposure to market risk associated with changes in interest rates related primarily to our debt obligations and short-term investment portfolio. Our debt obligations include variable-rate instruments, which have exposure to changes in interest rates. In order to mitigate the risk of interest rate fluctuations, we have a number of interest rate swaps that fix the interest rates on certain variable-rate debt agreements. A hypothetical 10% change in the average interest rates incurred on average variable-rate debt held during 2019 would have correspondingly changed our net earnings and cash flows associated with these items by less than \$5 million. Our variable-rate debt represents approximately 69% and 70% of our total long-term debt as of December 31, 2019 and December 31, 2018. Approximately \$717 million of the Company's total variable-rate notes payable were effectively fixed via interest rate swaps at December 31, 2019.

Our exposure to interest rate variability is further mitigated through our variable-rate investment portfolio. We also have investments in marketable securities, which are exposed to market risk associated with changes in interest rates. If short-term interest rates were to average one point more than they did in 2019, interest income would increase by approximately \$12 million.

Our variable-rate instruments, including long-term debt, interest rate swaps, and credit facilities, all make reference to the London Interbank Offered Rate (LIBOR) as the interest rate benchmark. It is expected that after 2021, LIBOR will be discontinued as a reference rate. In the event of the discontinuance of LIBOR, we will need to transition our LIBOR-based contracts to a mutually agreed-upon alternate benchmark rate, which effectively places the Lenders and the Company in the same economic position that existed immediately prior to the discontinuance of LIBOR. At this time, we do not anticipate that the discontinuance of LIBOR will materially impact our liquidity or financial position.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SELECTED QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (unaudited)

| <i>(in millions, except per share)</i> | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | |
|---|---------------|----------|----------------|----------|---------------|----------|----------------|----------|
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| Operating revenues | \$ 1,876 | \$ 1,832 | \$ 2,288 | \$ 2,156 | \$ 2,389 | \$ 2,212 | \$ 2,228 | \$ 2,064 |
| Operating income | 25 | 29 | 364 | 271 | 422 | 297 | 252 | 46 |
| Net income | 4 | 4 | 262 | 193 | 322 | 217 | 181 | 23 |
| Basic earnings per share ^(a) | 0.03 | 0.03 | 2.12 | 1.57 | 2.61 | 1.76 | 1.47 | 0.19 |
| Diluted earnings per share ^(a) | 0.03 | 0.03 | 2.11 | 1.56 | 2.60 | 1.75 | 1.46 | 0.19 |

^(a) For earnings per share, the sum of the quarters may not equal the total for the full year due to rounding.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Alaska Air Group, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Alaska Air Group, Inc. and subsidiaries (the Company) as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 12, 2020 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Change in Accounting Principle

As discussed in Note 6 to the consolidated financial statements, the Company has changed its method of accounting for leases as of January 1, 2019 due to the adoption of Accounting Standards Codification Topic 842 – *Leases*.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgment. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Assessment of Mileage Plan™ Model

As discussed in Note 2 to the consolidated financial statements, the Company has a Mileage Plan™ loyalty program which provides frequent flyer travel awards to program members based upon accumulated loyalty mileage credits. The Company utilizes a complex model to account for the Mileage Plan™ program, which involves numerous inputs and assumptions. Deferred revenues related to the Mileage Plan™ program were \$2.0 billion as of December 31, 2019. Associated Mileage Plan™ revenues recognized from deferred revenue and recorded in passenger revenue were \$704 million for the year ended December 2019.

We identified the assessment of the Mileage Plan™ model as a critical audit matter. This was due to the high degree of auditor judgment to assess that sufficient audit evidence was obtained over the complex design of the model as well as the key inputs and assumptions used to develop the estimates. Key inputs include miles credited and miles redeemed and key assumptions include estimated breakage and the standalone selling price of a mile.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's Mileage Plan™ process, including controls over the integrity of the model as well as key inputs and key assumptions utilized in the model. We reperformed key calculations utilized in the Mileage Plan™ accounting model. We tested that the miles credited and miles redeemed inputs matched information technology system data. We inspected that the Company's methodology to develop key assumptions was consistent with historical methods. We compared the breakage rate assumption to historical breakage and breakage rates used by others in the airline industry. We considered changes in the Mileage Plan™ program terms and customer behavior for potential changes in the breakage rate. We evaluated the fluctuation in the standalone selling price of a mile assumption by comparing it to changes in passenger ticket fares. We compared the standalone selling price of a mile assumption to other data points including miles sold on the Company's website and the contractual rates that miles are sold to other airline and bank partners. We evaluated fluctuations in Mileage Plan™ balances in relation to program changes, economic conditions, and observed industry trends and events.

In addition, we evaluated the overall sufficiency of audit evidence obtained over the Mileage Plan™ model.

/s/ KPMG LLP

We have served as the Company's auditor since 2004.

Seattle, Washington
February 12, 2020

CONSOLIDATED BALANCE SHEETS

| As of December 31 (in millions) | 2019 | 2018 |
|--|------------------|------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 221 | \$ 105 |
| Marketable securities | 1,300 | 1,131 |
| Total cash and marketable securities | 1,521 | 1,236 |
| Receivables - net | 323 | 366 |
| Inventories and supplies - net | 72 | 60 |
| Prepaid expenses and other current assets | 121 | 125 |
| Total Current Assets | 2,037 | 1,787 |
| Property and Equipment | | |
| Aircraft and other flight equipment | 8,549 | 8,221 |
| Other property and equipment | 1,306 | 1,363 |
| Deposits for future flight equipment | 533 | 439 |
| | 10,388 | 10,023 |
| Less accumulated depreciation and amortization | 3,486 | 3,242 |
| Total Property and Equipment - Net | 6,902 | 6,781 |
| Other Assets | | |
| Operating lease assets | 1,711 | — |
| Goodwill | 1,943 | 1,943 |
| Intangible assets - net | 122 | 127 |
| Other noncurrent assets | 278 | 274 |
| Total Other Assets | 4,054 | 2,344 |
| Total Assets | \$ 12,993 | \$ 10,912 |

CONSOLIDATED BALANCE SHEETS (continued)

| As of December 31 (in millions except share amounts) | 2019 | 2018 |
|---|------------------|------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 146 | \$ 132 |
| Accrued wages, vacation and payroll taxes | 470 | 415 |
| Air traffic liability | 900 | 788 |
| Other accrued liabilities | 431 | 416 |
| Deferred revenue | 750 | 705 |
| Current portion of operating lease liabilities | 269 | — |
| Current portion of long-term debt | 235 | 486 |
| Total Current Liabilities | 3,201 | 2,942 |
| Long-Term Debt, Net of Current Portion | 1,264 | 1,617 |
| Other Liabilities and Credits | | |
| Long-term operating lease liabilities, net of current portion | 1,439 | — |
| Deferred income taxes | 715 | 512 |
| Deferred revenue | 1,240 | 1,169 |
| Obligation for pension and postretirement medical benefits | 571 | 503 |
| Other liabilities | 232 | 418 |
| Total Other Liabilities and Credits | 4,197 | 2,602 |
| Commitments and Contingencies (Note 9) | | |
| Shareholders' Equity | | |
| Preferred stock, \$0.01 par value, Authorized: 5,000,000 shares, none issued or outstanding | — | — |
| Common stock, \$0.01 par value, Authorized: 400,000,000 shares, Issued: 2019 - 131,812,173 shares; 2018 - 130,813,476 shares, Outstanding: 2019 - 123,000,307 shares; 2018 - 123,194,430 shares | 1 | 1 |
| Capital in excess of par value | 305 | 232 |
| Treasury stock (common), at cost: 2019 - 8,811,866 shares; 2018 - 7,619,046 shares | (643) | (568) |
| Accumulated other comprehensive loss | (465) | (448) |
| Retained earnings | 5,133 | 4,534 |
| | 4,331 | 3,751 |
| Total Liabilities and Shareholders' Equity | \$ 12,993 | \$ 10,912 |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

| Year Ended December 31 (in millions, except per-share amounts) | 2019 | 2018 | 2017 |
|--|---------------|---------------|---------------|
| Operating Revenues | | | |
| Passenger revenue | \$ 8,095 | \$ 7,631 | \$ 7,301 |
| Mileage Plan other revenue | 465 | 434 | 418 |
| Cargo and other | 221 | 199 | 175 |
| Total Operating Revenues | 8,781 | 8,264 | 7,894 |
| Operating Expenses | | | |
| Wages and benefits | 2,370 | 2,190 | 1,931 |
| Variable incentive pay | 163 | 147 | 135 |
| Aircraft fuel, including hedging gains and losses | 1,878 | 1,936 | 1,447 |
| Aircraft maintenance | 437 | 435 | 391 |
| Aircraft rent | 331 | 315 | 274 |
| Landing fees and other rentals | 531 | 499 | 460 |
| Contracted services | 289 | 306 | 314 |
| Selling expense | 313 | 326 | 368 |
| Depreciation and amortization | 423 | 398 | 372 |
| Food and beverage service | 214 | 211 | 195 |
| Third-party regional carrier expense | 166 | 154 | 121 |
| Other | 559 | 572 | 562 |
| Special items - merger-related costs | 44 | 87 | 116 |
| Special items - other | — | 45 | — |
| Total Operating Expenses | 7,718 | 7,621 | 6,686 |
| Operating Income | 1,063 | 643 | 1,208 |
| Non-operating Income (Expense) | | | |
| Interest income | 42 | 38 | 34 |
| Interest expense | (78) | (91) | (103) |
| Interest capitalized | 15 | 18 | 17 |
| Other - net | (26) | (23) | 3 |
| | (47) | (58) | (49) |
| Income Before Income Tax | 1,016 | 585 | 1,159 |
| Income tax expense | 247 | 148 | 436 |
| Special income tax benefit | — | — | (237) |
| Total Income Tax Expense | \$ 247 | \$ 148 | \$ 199 |
| Net Income | \$ 769 | \$ 437 | \$ 960 |
| Basic Earnings Per Share | | | |
| | \$ 6.24 | \$ 3.55 | \$ 7.79 |
| Diluted Earnings Per Share | | | |
| | \$ 6.19 | \$ 3.52 | \$ 7.75 |
| Shares used for computation: | | | |
| Basic | 123.279 | 123.230 | 123.211 |
| Diluted | 124.289 | 123.975 | 123.854 |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS

| Year Ended December 31 <i>(in millions)</i> | 2019 | 2018 | 2017 |
|--|---------------|---------------|---------------|
| Net Income | \$ 769 | \$ 437 | \$ 960 |
| Other Comprehensive Income (Loss): | | | |
| Related to marketable securities: | | | |
| Unrealized holding gains (losses) arising during the period | 31 | (14) | (4) |
| Reclassification of (gains) losses into Other-net non-operating income (expense) | (5) | 8 | 1 |
| Income tax benefit (expense) | (6) | 2 | 1 |
| Total | <u>20</u> | <u>(4)</u> | <u>(2)</u> |
| Related to employee benefit plans: | | | |
| Actuarial losses related to pension and other postretirement benefit plans | (71) | (34) | (123) |
| Reclassification of net pension expense into Wages and benefits and Other-net non-operating income | 32 | 28 | 22 |
| Income tax benefit (expense) | 10 | 2 | 24 |
| Total | <u>(29)</u> | <u>(4)</u> | <u>(77)</u> |
| Related to interest rate derivative instruments: | | | |
| Unrealized holding gains (losses) arising during the period | (13) | — | 1 |
| Reclassification of losses into Aircraft rent | 3 | 3 | 5 |
| Income tax benefit (expense) | 2 | (1) | (2) |
| Total | <u>(8)</u> | <u>2</u> | <u>4</u> |
| Other Comprehensive Loss | (17) | (6) | (75) |
| Comprehensive Income | \$ 752 | \$ 431 | \$ 885 |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

| <i>(in millions)</i> | <i>Common Stock Outstanding</i> | <i>Common Stock</i> | <i>Capital in Excess of Par Value</i> | <i>Treasury Stock</i> | <i>Accumulated Other Comprehensive Income (Loss)</i> | <i>Retained Earnings</i> | <i>Total</i> |
|--|-------------------------------------|-------------------------|---|---------------------------|--|------------------------------|-----------------|
| Balances at December 31, 2016 | 123.328 | \$ 1 | \$ 110 | \$ (443) | \$ (305) | \$ 3,381 | \$ 2,744 |
| 2017 net income | — | — | — | — | — | 960 | 960 |
| Other comprehensive income (loss) | — | — | — | — | (75) | — | (75) |
| Common stock repurchases | (0.981) | — | — | (75) | — | — | (75) |
| Stock-based compensation | — | — | 34 | — | — | — | 34 |
| Cash dividend declared (\$1.20 per share) | — | — | — | — | — | (148) | (148) |
| Stock issued for employee stock purchase plan | 0.407 | — | 24 | — | — | — | 24 |
| Stock issued under stock plans | 0.307 | — | (4) | — | — | — | (4) |
| Balances at December 31, 2017 | 123.061 | 1 | 164 | (518) | (380) | 4,193 | 3,460 |
| Reclassification of tax effects to retained earnings | — | — | — | — | (62) | 62 | — |
| 2018 net income | — | — | — | — | — | 437 | 437 |
| Other comprehensive income (loss) | — | — | — | — | (6) | — | (6) |
| Common stock repurchases | (0.776) | — | — | (50) | — | — | (50) |
| Stock-based compensation | — | — | 36 | — | — | — | 36 |
| Cash dividend declared (\$1.28 per share) | — | — | — | — | — | (158) | (158) |
| Stock issued for employee stock purchase plan | 0.632 | — | 35 | — | — | — | 35 |
| Stock issued under stock plans | 0.277 | — | (3) | — | — | — | (3) |
| Balances at December 31, 2018 | 123.194 | 1 | 232 | (568) | (448) | 4,534 | 3,751 |
| Cumulative effect of accounting changes ^(a) | — | — | — | — | — | 3 | 3 |
| 2019 net income | — | — | — | — | — | 769 | 769 |
| Other comprehensive income (loss) | — | — | — | — | (17) | — | (17) |
| Common stock repurchases | (1.193) | — | — | (75) | — | — | (75) |
| Stock-based compensation | — | — | 36 | — | — | — | 36 |
| Cash dividend declared (\$1.40 per share) | — | — | — | — | — | (173) | (173) |
| Stock issued for employee stock purchase plan | 0.785 | — | 40 | — | — | — | 40 |
| Stock issued under stock plans | 0.214 | — | (3) | — | — | — | (3) |
| Balances at December 31, 2019 | 123.000 | \$ 1 | \$ 305 | \$ (643) | \$ (465) | \$ 5,133 | \$ 4,331 |

(a) Represents the opening balance sheet adjustment recorded as a result of the adoption of the new lease accounting standard.

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

| Year Ended December 31 (in millions) | 2019 | 2018 | 2017 |
|--|----------------------|----------------------|----------------------|
| Cash flows from operating activities: | | | |
| Net income | \$ 769 | \$ 437 | \$ 960 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 423 | 398 | 372 |
| Stock-based compensation and other | 29 | 47 | 55 |
| Changes in certain assets and liabilities: | | | |
| Changes in deferred tax provision | 209 | 146 | 45 |
| (Increase) decrease in accounts receivable | 43 | (25) | (39) |
| Increase (decrease) in air traffic liability | 112 | (18) | 45 |
| Increase (decrease) in deferred revenue | 116 | 149 | 191 |
| Changes in pension and other postretirement benefits | 68 | 52 | 17 |
| Pension contribution | (65) | — | (15) |
| Other - net | 18 | 9 | (41) |
| Net cash provided by operating activities | <u>1,722</u> | <u>1,195</u> | <u>1,590</u> |
| Cash flows from investing activities: | | | |
| Property and equipment additions: | | | |
| Aircraft and aircraft purchase deposits | (356) | (686) | (804) |
| Other flight equipment | (178) | (105) | (96) |
| Other property and equipment | (162) | (169) | (126) |
| Total property and equipment additions | <u>(696)</u> | <u>(960)</u> | <u>(1,026)</u> |
| Purchases of marketable securities | (1,810) | (834) | (1,569) |
| Sales and maturities of marketable securities | 1,674 | 1,116 | 1,388 |
| Proceeds from disposition of assets and changes in restricted deposits | 41 | 47 | 78 |
| Net cash used in investing activities | <u>(791)</u> | <u>(631)</u> | <u>(1,129)</u> |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of long-term debt, net of issuance costs | 450 | 339 | — |
| Long-term debt payments | (1,058) | (807) | (397) |
| Common stock repurchases | (75) | (50) | (75) |
| Cash dividend paid | (173) | (158) | (148) |
| Other financing activities | 43 | 29 | 28 |
| Net cash used in financing activities | <u>(813)</u> | <u>(647)</u> | <u>(592)</u> |
| Net increase (decrease) in cash, cash equivalents, and restricted cash | <u>118</u> | <u>(83)</u> | <u>(131)</u> |
| Cash, cash equivalents, and restricted cash at beginning of year | <u>114</u> | <u>197</u> | <u>328</u> |
| Cash, cash equivalents, and restricted cash at end of year | <u><u>\$ 232</u></u> | <u><u>\$ 114</u></u> | <u><u>\$ 197</u></u> |
| Supplemental disclosure: | | | |
| Cash paid during the year for: | | | |
| Interest, net of amount capitalized | \$ 60 | \$ 72 | \$ 84 |
| Income taxes, net of refunds received | 31 | — | 177 |
| Reconciliation of cash, cash equivalents, and restricted cash at end of the period | | | |
| Cash and cash equivalents | \$ 221 | \$ 105 | \$ 194 |
| Restricted cash included in Other noncurrent assets | 11 | 9 | 3 |
| Total cash, cash equivalents, and restricted cash at end of the period | <u>\$ 232</u> | <u>\$ 114</u> | <u>\$ 197</u> |

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

The consolidated financial statements include the accounts of Air Group, or the Company, and its primary subsidiaries, Alaska and Horizon. Our consolidated financial statements also include McGee Air Services, a ground services subsidiary of Alaska. The Company conducts substantially all of its operations through these subsidiaries. All significant intercompany balances and transactions have been eliminated. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and their preparation requires the use of management's estimates. Actual results may differ from these estimates.

Certain reclassifications have been made to prior year financial statements to conform to classifications used in the current year.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with original maturities of three months or less, such as money market funds, commercial paper and certificates of deposit. They are carried at cost, which approximates market value. The Company reduces cash balances when funds are disbursed. Due to the time delay in funds clearing the banks, the Company normally maintains a negative balance in its cash disbursement accounts, which is reported as a current liability. The amount of the negative cash balance was \$7 million and \$5 million at December 31, 2019 and 2018, and is included in accounts payable, with the change in the balance during the year included in other financing activities in the consolidated statements of cash flows.

The Company's restricted cash balances are not material and are classified as Other noncurrent assets. Restricted cash balances are primarily used to guarantee various letters of credit, self-insurance programs or other contractual rights. They consist of highly liquid securities with original maturities of three months or less. They are carried at cost, which approximates fair value.

Marketable Securities

Investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash equivalents and short-term investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in market value, excluding other-than-temporary impairments, are reflected in accumulated other comprehensive loss (AOCL).

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. The Company uses a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment. If the cost of an investment exceeds its fair value, management evaluates, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, the Company's intent and ability to hold, or plans to sell, the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to Other—net in the consolidated statements of operations and a new cost basis in the investment is established.

Inventories and Supplies—net

Expendable aircraft parts, materials and supplies are stated at average cost and are included in Inventories and supplies—net. An obsolescence allowance for expendable parts is accrued based on estimated lives of the corresponding fleet type and salvage values. The allowance for expendable inventories was \$41 million and \$39 million at December 31, 2019 and 2018. Inventory and supplies—net also includes fuel inventory of \$28 million and \$24 million at December 31, 2019 and 2018. Repairable and rotatable aircraft parts inventories are included in flight equipment.

Property, Equipment and Depreciation

Property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives less an estimated salvage value, which are as follows:

| | Estimated Useful Life | Estimated Salvage Value |
|---|--|-------------------------|
| Aircraft and other flight equipment: | | |
| Boeing 737, Airbus A319/A320, and E175 aircraft | 20-25 years | 10% |
| Bombardier Q400 aircraft | 15 years | 5% |
| Buildings | 25 - 40 years | 10% |
| Minor building and land improvements | 10 years | —% |
| Capitalized leases and leasehold improvements | Generally shorter of lease term or estimated useful life | —% |
| Computer hardware and software | 3-10 years | —% |
| Other furniture and equipment | 5-10 years | —% |

Near the end of an asset's estimated useful life, management updates the salvage value estimates based on current market conditions and expected use of the asset. Repairable and rotatable aircraft parts are included in Aircraft and other flight equipment, and are depreciated over the associated fleet life.

Capitalized interest, based on the Company's weighted-average borrowing rate, is added to the cost of the related asset, and is depreciated over the estimated useful life of the asset.

Maintenance and repairs, other than engine maintenance on B737-800 engines, are expensed when incurred. Major modifications that extend the life or improve the usefulness of aircraft are capitalized and depreciated over their estimated period of use. Maintenance on B737-800 engines is covered under a power-by-the-hour agreement with a third party, whereby the Company pays a determinable amount, and transfers risk, to a third party. The Company expenses the contract amounts based on engine usage.

The Company evaluates long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate that the total carrying amount of an asset or asset group may not be recoverable. The Company groups assets for purposes of such reviews at the lowest level at which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities, which is generally the fleet level. An impairment loss is considered when estimated future undiscounted cash flows expected to result from the use of the asset or asset group and its eventual disposition are less than its carrying amount. If the asset or asset group is not considered recoverable, a write-down equal to the excess of the carrying amount over the fair value will be recorded.

Goodwill

Goodwill represents the excess of purchase price over the fair value of the related net assets acquired in the Company's acquisition of Virgin America and is not amortized. The total balance of goodwill is associated with the Mainline reporting unit. The Company reviews goodwill for impairment annually in Q4, or more frequently if events or circumstances indicate that an impairment may exist. If fair value of the reporting unit does not exceed the carrying amount, an impairment charge may be recorded. In 2019, the fair value of the reporting unit with goodwill substantially exceeded its carrying value.

Intangible Assets

Intangible assets recorded in conjunction with the acquisition of Virgin America consist primarily of indefinite-lived airport slots, finite-lived airport gates and finite-lived customer relationships. Finite-lived intangibles are amortized over their estimated useful lives. Indefinite-lived intangibles are not amortized, but are tested at least annually for impairment using a similar methodology to property, equipment and goodwill, as described above.

Aircraft Maintenance Deposits

Certain Airbus leases include contractually required maintenance deposit payments to the lessor, which collateralize the lessor for future maintenance events should the Company not perform required maintenance. Most of the lease agreements provide that maintenance deposits are reimbursable upon completion of the major maintenance event in an amount equal to the lesser of

(i) the amount qualified for reimbursement from maintenance deposits held by the lessor associated with the specific major maintenance event or (ii) the qualifying costs related to the specific major maintenance event. The Company establishes accounting maintenance deposits based on the anticipated timing and cost of the specific major maintenance events, such that the accounting deposits do not exceed the amount qualified for reimbursement. Aircraft maintenance deposits were \$143 million and \$90 million as of December 31, 2019 and December 31, 2018.

Leased Aircraft Return Costs

Cash payments associated with returning leased aircraft are accrued when it is probable that a cash payment will be made and that amount is reasonably estimable, usually no sooner than after the last scheduled maintenance event prior to lease return. Any accrual is based on the time remaining on the lease, planned aircraft usage and the provisions included in the lease agreement, although the actual amount due to any lessor upon return may not be known with certainty until lease termination.

As leased aircraft are returned, any payments are charged against the established accrual. The accrual is part of other current and long-term liabilities and was not material as of December 31, 2019 and December 31, 2018. The expense is included in Aircraft maintenance in the consolidated statements of operations.

Advertising Expenses

The Company's advertising expenses include advertising and promotional costs. Advertising production costs are expensed as incurred. Advertising expense was \$72 million, \$79 million and \$91 million during the years ended December 31, 2019, 2018 and 2017.

Derivative Financial Instruments

The Company's operations are significantly impacted by changes in aircraft fuel prices and interest rates. In an effort to manage exposure to these risks, the Company periodically enters into fuel and interest rate derivative instruments. These derivative instruments are recognized at fair value on the balance sheet and changes in the fair value are recognized in AOCL or in the consolidated statements of operations, depending on the nature of the instrument.

The Company does not apply hedge accounting to its derivative fuel hedge contracts nor does it hold or issue them for trading purposes. For cash flow hedges related to interest rate swaps, the effective portion of the derivative represents the change in fair value of the hedge that offsets the change in fair value of the hedged item. To the extent the change in the fair value of the hedge does not perfectly offset the change in the fair value of the hedged item, the ineffective portion of the hedge is immediately recognized in interest expense.

Fair Value Measurements

Accounting standards define fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The standards also establish a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company has elected not to use the fair value option provided in the accounting standards for non-financial instruments. Accordingly, those assets and liabilities are carried at amortized cost. For financial instruments, the assets and liabilities are carried at fair value, which is determined based on the market approach or income approach, depending upon the level of inputs used.

Assets and liabilities recognized or disclosed at fair value on a nonrecurring basis include items such as property, plant and equipment, goodwill, intangible assets and certain other assets and liabilities. The Company determines the fair value of these items using Level 3 inputs, as described in Note 4.

Income Taxes

The Company uses the asset and liability approach for accounting for and reporting income taxes. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases and for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. A valuation allowance would be established, if necessary, for the amount of any tax benefits that, based on available evidence, are not expected to be realized. As of December 31, 2019, there is a partial valuation allowance against net deferred tax assets. The Company accounts for unrecognized tax benefits in accordance with the applicable accounting standards.

The Company has substantial federal and state net operating losses (NOLs) for income tax purposes as a result of the acquisition of Virgin America. The Company's ability to utilize Virgin America's NOLs is limited by previous "ownership changes," as defined in Section 382 of the Internal Revenue Code and similar state provisions, and could be further limited if there is another ownership change. In general terms, an ownership change can occur whenever there is a collective shift in the ownership of a company by more than 50% by one or more "5% stockholders" within a three-year period. The occurrence of such a change generally limits the amount of NOL carryforwards a company could utilize in a given year to the aggregate fair market value of the company's common stock immediately prior to the ownership change, multiplied by the long-term tax-exempt interest rate in effect for the month of the ownership change. The acquisition constituted an ownership change and the potential for further limitations following the acquisition. See Note 7 to the consolidated financial statements for more discussion of the calculation.

Stock-Based Compensation

Accounting standards require companies to recognize as expense the fair value of stock options and other equity-based compensation issued to employees as of the grant date. These standards apply to all stock awards that the Company grants to employees as well as the Company's Employee Stock Purchase Plan (ESPP), which features a look-back provision and allows employees to purchase stock at a 15% discount. All stock-based compensation expense is recorded in wages and benefits in the consolidated statements of operations.

Earnings Per Share (EPS)

Diluted EPS is calculated by dividing net income by the average common shares outstanding plus additional common shares that would have been outstanding assuming the exercise of in-the-money stock options and restricted stock units, using the treasury-stock method. In 2019, 2018, and 2017, anti-dilutive stock options excluded from the calculation of EPS were not material.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to recognize assets and liabilities for leases currently classified as operating leases. In July 2018, the FASB issued ASU 2018-11, "Targeted Improvements - Leases (Topic 842)" which amended Topic 842 to provide companies an alternative transition method which would not require adjusting comparative period financial information. The Company elected this transition method upon adoption on January 1, 2019. As a result, the Company recorded a cumulative-effect adjustment to the opening balance of retained earnings upon transition. This adjustment is discussed further in Note 6.

NOTE 2. REVENUE

Ticket revenue is recorded as Passenger revenue, and represents the primary source of the Company's revenue. Also included in Passenger revenue are passenger ancillary revenues such as bag fees, on-board food and beverage, ticket change fees, and certain revenue from the frequent flyer program. Mileage Plan other revenue includes brand and marketing revenue from our co-branded credit card and other partners and certain interline frequent flyer revenue, net of commissions. Cargo and other revenue includes freight and mail revenue, and to a lesser extent, other ancillary revenue products such as lounge membership and certain commissions.

The Company disaggregates revenue by segment in Note 13. The level of detail within the Company's statements of operations, segment disclosures, and in this footnote depict the nature, amount, timing and uncertainty of revenue and how cash flows are affected by economic and other factors.

Passenger Ticket and Ancillary Services Revenue

The primary performance obligation on a typical passenger ticket is to provide air travel to the passenger. Ticket revenue is collected in advance of travel and recorded as Air Traffic Liability (ATL) on the consolidated balance sheets. The Company satisfies its performance obligation and recognizes ticket revenue for each flight segment when the transportation is provided.

Ancillary passenger revenues relate to items such as checked-bag fees, ticket change fees, and on-board food and beverage sales, all of which are provided at time of flight. As such, the obligation to perform these services is satisfied at the time of travel and is recorded with ticket revenue in Passenger revenue.

Revenue is also recognized for tickets that are expected to expire unused, a concept referred to as "passenger ticket breakage." Passenger ticket breakage is recorded at the flight date using estimates made at the time of sale based on the Company's historical experience of expired tickets, and other facts such as program changes and modifications.

In addition to selling tickets on its own marketed flights, Alaska has interline agreements with partner airlines under which it sells multi-city tickets with one or more segments of the trip flown by a partner airline, or it operates a connecting flight sold by a partner airline. Each segment in a connecting flight represents a separate performance obligation. Revenue on segments sold and operated by the Company is recognized as Passenger revenue in the gross amount of the allocated ticket price when the travel occurs, while the commission paid to the partner airline is recognized as a selling expense when the related transportation is provided. Revenue on segments operated by a partner airline is deferred for the full amount of the consideration received at the time the ticket is sold and, once the segment has been flown the Company records the net amount, after compensating the partner airline, as Cargo and other revenue.

A portion of revenue from the Mileage Plan™ program is recorded in Passenger revenue. As members are awarded mileage credits on flown tickets, these credits become a distinct performance obligation to the Company. The Company allocates the transaction price to each performance obligation identified in a passenger ticket contract on a relative standalone selling price basis. The standalone selling price for loyalty mileage credits issued is discussed in the *Loyalty Mileage Credits* section of this Note below. The amount allocated to the mileage credits is deferred on the balance sheet. Once a member travels using a travel award redeemed with mileage credits on one of the Company's airline carriers, the revenue associated with those mileage credits is recorded as Passenger revenue.

Taxes collected from passengers, including transportation excise taxes, airport and security fees and other fees, are recorded on a net basis within passenger revenue in the consolidated statements of operations.

Passenger revenue recognized in the consolidated statements of operations (in millions):

| | Twelve Months Ended December 31, | | |
|---|----------------------------------|-----------------|-----------------|
| | 2019 | 2018 | 2017 |
| Passenger ticket revenue, including ticket breakage and net of taxes and fees | \$ 6,824 | \$ 6,482 | \$ 6,246 |
| Passenger ancillary revenue | 567 | 530 | 514 |
| Mileage Plan passenger revenue | 704 | 619 | 541 |
| Total passenger revenue | \$ 8,095 | \$ 7,631 | \$ 7,301 |

As passenger tickets and related ancillary services are primarily sold via credit cards, certain amounts due from credit card processors are recorded as airline traffic receivables. These credit card receivables and receivables from our affinity credit card partner represent the majority of the receivables balance on the consolidated balance sheets.

For performance obligations with performance periods of less than one year, GAAP provides a practical expedient that allows the Company not to disclose the transaction price allocated to remaining performance obligations and the timing of related revenue recognition. As passenger tickets expire one year from ticketing, if unused or not exchanged, the Company elected to apply this practical expedient.

Mileage Plan™ Loyalty Program

Loyalty mileage credits

The Company's Mileage Plan™ loyalty program provides frequent flyer travel awards to program members based upon accumulated loyalty mileage credits. Mileage credits are earned through travel, purchases using the Mileage Plan™ co-branded credit card and purchases from other participating partners. The program has a 24 month expiration period for unused mileage credits from the month of last account activity. The Company offers redemption of mileage credits through free, discounted or upgraded air travel on flights operated by Alaska and its regional partners or on one of its 17 airline partners, as well as redemption at partner hotels.

The Company uses a relative standalone selling price to allocate consideration to material performance obligations in contracts with customers that include loyalty mileage credits. As directly observable selling prices for mileage credits are not available, the Company determines the standalone selling price of mileage credits primarily using actual ticket purchase prices for similar tickets flown, adjusted for the likelihood of redemption, or breakage. In determining similar tickets flown, the Company considers current market prices, class of service, type of award, and other factors. For mileage credits accumulated through travel on partner airlines, the Company uses actual consideration received from the partners.

Revenue related to air transportation is deferred in the amount of the relative standalone selling price allocated to the loyalty mileage credits as they are issued. The Company satisfies its performance obligation when the mileage credits are redeemed and the related air transportation is delivered.

The Company estimates breakage for the portion of loyalty mileage credits not expected to be redeemed using a statistical analysis of historical data, including actual mileage credits expiring, slow-moving and low-credit accounts, among other factors. The breakage rate for the twelve months ended December 31, 2019 and 2018 was 17.4%. The Company reviews the breakage rate used on an annual basis.

Co-brand credit card agreements and other

In addition to mileage credits, the co-brand credit card agreements, referred to herein as the Agreements, also include performance obligations for waived bag fees, Companion Fare™ offers to purchase an additional ticket at a discount, marketing, and the use of intellectual property including the brand (unlimited access to the use of the Company's brand and frequent flyer member lists), which is the predominant element in the Agreement. The co-brand card bank partners are the customer for some elements, including the brand and marketing, while the Mileage Plan™ member is the customer for other elements such as mileage credits, bag waivers, and companion fares.

At the inception of the Agreement, management estimated the selling price of each of the performance obligations. The objective was to determine the price at which a sale would be transacted if the product or service was sold on a stand-alone basis. The Company determined its best estimate of selling price for each element by considering multiple inputs and methods including, but not limited to, the estimated selling price of comparable travel, discounted cash flows, brand value, published selling prices, number of miles awarded and number of miles redeemed. The Company estimated the selling prices and volumes over the term of the Agreement in order to determine the allocation of proceeds to each of the multiple deliverables. The estimates of the standalone selling prices of each element do not change subsequent to the original valuation of the contract unless the contract is materially modified, but the allocation between elements may change based upon the actual and updated projected volumes of each element delivered during the term of the contract.

Consideration received from the banks is variable and is primarily from consumer spend on the card, among other items. The Company allocates consideration to each of the performance obligations, including mileage credits, waived bag fees, companion fares, and brand and marketing, using their relative standalone selling price. Because the performance obligation related to providing use of intellectual property including the brand is satisfied over time, it is recognized in Mileage Plan™ other revenue in the period that those elements are sold. The Company records passenger revenue related to the air transportation and certificates for discounted companion travel when the transportation is delivered.

In contracts with non-bank partners, the Company has identified two performance obligations in most cases - travel and brand. The travel performance obligation is deferred until the transportation is provided in the amount of the estimated standalone selling price of the ticket, less breakage, and the brand performance obligation is recognized using the residual method as commission revenue when the brand element is sold. Mileage credit sales recorded under the residual approach are immaterial to the overall program.

Interline loyalty

Alaska has interline arrangements with certain airlines whereby its members may earn and redeem Mileage Plan™ credits on those airlines, and members of a partner airline's loyalty program may earn and redeem frequent flyer program credits on flights operated by Alaska and its regional partners. When a Mileage Plan™ member earns credits on a partner airline, the partner airline remits a contractually-agreed upon fee to the Company which is deferred until credits are redeemed. When a Mileage Plan™ member redeems credits on a partner airline, the Company pays a contractually agreed upon fee to the other airline, which is netted against the revenue recognized associated with the award travel. When a member of a partner airline redeems frequent flyer credits on Alaska, the partner airline remits a contractually-agreed upon amount to the Company, recognized as Passenger revenue upon travel. If the partner airline's member earns frequent flyer program credits on an Alaska flight, the Company remits a contractually-agreed upon fee to the partner airline and records a commission expense.

Mileage Plan revenue included in the consolidated statements of operations (in millions):

| | Twelve Months Ended December 31, | | |
|-----------------------------------|----------------------------------|-----------------|---------------|
| | 2019 | 2018 | 2017 |
| Passenger revenue | \$ 704 | \$ 619 | \$ 541 |
| Mileage Plan other revenue | 465 | 434 | 418 |
| Total Mileage Plan revenue | \$ 1,169 | \$ 1,053 | \$ 959 |

Mileage Plan other revenue is primarily brand and marketing revenue from our affinity card products.

Cargo and Other

The Company provides freight and mail services (cargo). The majority of cargo services are provided to commercial businesses and the United States Postal Service. The Company satisfies cargo service performance obligations and recognizes revenue when the shipment arrives at its final destination, or is transferred to a third-party carrier for delivery.

The Company also earns other revenue for lounge memberships, hotel and car commissions, and certain other immaterial items not intrinsically tied to providing air travel to passengers. Revenue is recognized when these services are rendered and recorded as Cargo and other revenue. The transaction price for Cargo and other revenue is the price paid by the customer.

Cargo and other revenue included in the consolidated statements of operations (in millions):

| | Twelve Months Ended December 31, | | |
|--------------------------------------|----------------------------------|---------------|---------------|
| | 2019 | 2018 | 2017 |
| Cargo revenue | \$ 133 | \$ 129 | \$ 115 |
| Other revenue | 88 | 70 | 60 |
| Total Cargo and other revenue | \$ 221 | \$ 199 | \$ 175 |

Air Traffic Liability and Deferred Revenue

Passenger ticket and ancillary services liabilities

Air traffic liability included on the consolidated balance sheets represents the remaining obligation associated with passenger tickets and ancillary services. The air traffic liability balance fluctuates with seasonal travel patterns. The Company recognized Passenger revenue of \$577 million and \$583 million from the 2018 and 2017 year-end air traffic liability balance during the twelve months ended December 31, 2019 and 2018.

Mileage Plan™ liabilities

The total deferred revenue liability included on the consolidated balance sheets represents the remaining transaction price that has been allocated to Mileage Plan™ performance obligations not yet satisfied by the Company. In general, the current amounts will be recognized as revenue within 12 months and the long-term amounts will be recognized as revenue over a period of approximately three to four years. This period of time represents the average time that members have historically taken to earn and redeem miles.

The Company records a receivable for amounts due from the affinity card partner and from other partners as mileage credits are sold until the payments are collected. The Company had \$105 million and \$119 million of such receivables as of December 31, 2019 and December 31, 2018.

Mileage credits are combined into one homogeneous pool and are not specifically identifiable. As such, loyalty revenues disclosed earlier in this Note are comprised of miles that were part of the deferred revenue and liabilities balances at the beginning of the period and miles that were issued during the period. The table below presents a roll forward of the total frequent flyer liability (in millions):

| | Twelve Months Ended December 31, | |
|---|----------------------------------|-----------------|
| | 2019 | 2018 |
| Total Deferred Revenue balance at January 1 | \$ 1,874 | \$ 1,725 |
| Travel miles and companion certificate redemption - Passenger revenue | (704) | (619) |
| Miles redeemed on partner airlines - Other revenue | (111) | (90) |
| Increase in liability for mileage credits issued | 931 | 858 |
| Total Deferred Revenue balance at December 31 | \$ 1,990 | \$ 1,874 |

Selling Costs

Certain costs such as credit card fees, travel agency and other commissions paid, as well as Global Distribution Systems (GDS) booking fees are incurred when the Company sells passenger tickets and ancillary services in advance of the travel date. The Company defers such costs and recognizes them as expenses when the travel occurs. Prepaid expense recorded on the consolidated balance sheets for such costs was \$27 million and \$23 million as of December 31, 2019 and December 31, 2018. The Company recorded related expense on the consolidated statement of operations of \$208 million, \$217 million and \$238 million for the twelve months ended December 31, 2019, 2018 and 2017.

NOTE 3. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

Fuel Hedge Contracts

The Company's operations are inherently dependent upon the price and availability of aircraft fuel. To manage economic risks associated with fluctuations in aircraft fuel prices, the Company periodically enters into call options for crude oil.

As of December 31, 2019, the Company had outstanding fuel hedge contracts covering 435 million gallons of crude oil that will be settled from January 2020 to June 2021.

Interest Rate Swap Agreements

The Company is exposed to market risk from adverse changes in variable interest rates on long-term debt and certain aircraft lease agreements. To manage this risk, the Company periodically enters into interest rate swap agreements. As of December 31, 2019, the Company has outstanding interest rate swap agreements with a third party designed to hedge the volatility of the underlying variable interest rates on lease agreements for six B737-800 aircraft, as well as 13 interest rate swap agreements with third parties designed to hedge the volatility of the underlying variable interest rates on \$717 million of debt. All of the interest rate swap agreements stipulate that the Company pay a fixed interest rate and receive a floating interest rate over the term of the underlying contracts. The interest rate swap agreements expire from February 2020 through March 2021, associated with lease terms, and December 2021 through August 2029 to coincide with the debt maturity dates. All significant terms of the swap agreements match the terms of the underlying hedged items and have been designated as qualifying hedging instruments, which are accounted for as cash flow hedges.

As qualifying cash flow hedges, the interest rate swaps are recognized at fair value on the balance sheet, and changes in the fair value are recognized in accumulated other comprehensive loss. The effective portion of the derivative represents the change in fair value of the hedge that offsets the change in fair value of the hedged item. To the extent the change in fair value of the hedge does not perfectly offset the change in the fair value of the hedged item, the ineffective portion of the hedge is recognized in interest expense, if material.

Fair Values of Derivative Instruments

Fair values of derivative instruments on the consolidated balance sheet (in millions):

| | 2019 | 2018 |
|---|------|------|
| Fuel hedge contracts (not designated as hedges) | | |
| Prepaid expenses and other current assets | \$ 8 | \$ 2 |
| Other assets | 3 | 2 |
| Interest rate swaps (designated as hedges) | | |
| Prepaid expenses and other current assets | 1 | 3 |
| Other noncurrent assets | 2 | 7 |
| Other accrued liabilities | (5) | (3) |
| Other liabilities | (5) | (4) |
| Losses in accumulated other comprehensive loss (AOCL) | (13) | (1) |

The net cash paid for new fuel hedge positions and received from settlements was \$9 million, \$21 million and \$12 million during 2019, 2018, and 2017.

Pretax effect of derivative instruments on earnings and AOCL (in millions):

| | 2019 | 2018 | 2017 |
|---|---------|------|--------|
| Fuel hedge contracts (not designated as hedges) | | | |
| Gains (losses) recognized in Aircraft fuel | \$ (10) | \$ 1 | \$ (6) |
| Interest rate swaps (designated as hedges) | | | |
| Losses recognized in Aircraft rent | (3) | (3) | (5) |
| Gains (losses) recognized in other comprehensive income (OCI) | (13) | — | 1 |

The amounts shown as recognized in aircraft rent for cash flow hedges (interest rate swaps) represent the realized losses transferred out of AOCL to aircraft rent. No gains or losses related to interest rate swaps on variable rate debt have been recognized in interest expense during 2019. The amounts shown as recognized in OCI are prior to the losses recognized in aircraft rent during the period. The Company expects \$3 million to be reclassified from OCI to aircraft rent and \$4 million to interest income within the next twelve months.

NOTE 4. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments on a Recurring Basis

As of December 31, 2019, the total cost basis for marketable securities was \$1.3 billion. There were no significant differences between the cost basis and fair value of any individual class of marketable securities.

Fair values of financial instruments on the consolidated balance sheet (in millions):

| | December 31, 2019 | | | December 31, 2018 | | |
|---------------------------------------|-------------------|----------------|-----------------|-------------------|---------------|-----------------|
| | Level 1 | Level 2 | Total | Level 1 | Level 2 | Total |
| Assets | | | | | | |
| Marketable securities | | | | | | |
| U.S. government and agency securities | \$ 330 | \$ — | \$ 330 | \$ 293 | \$ — | \$ 293 |
| Equity mutual funds | 6 | — | 6 | — | — | — |
| Foreign government bonds | — | 31 | 31 | — | 26 | 26 |
| Asset-backed securities | — | 211 | 211 | — | 190 | 190 |
| Mortgage-backed securities | — | 176 | 176 | — | 92 | 92 |
| Corporate notes and bonds | — | 523 | 523 | — | 520 | 520 |
| Municipal securities | — | 23 | 23 | — | 10 | 10 |
| Total Marketable securities | 336 | 964 | 1,300 | 293 | 838 | 1,131 |
| Derivative instruments | | | | | | |
| Fuel hedge contracts - call options | — | 11 | 11 | — | 4 | 4 |
| Interest rate swap agreements | — | 3 | 3 | — | 10 | 10 |
| Total Assets | \$ 336 | \$ 978 | \$ 1,314 | \$ 293 | \$ 852 | \$ 1,145 |
| Liabilities | | | | | | |
| Derivative instruments | | | | | | |
| Interest rate swap agreements | — | (10) | (10) | — | (7) | (7) |
| Total Liabilities | \$ — | \$ (10) | \$ (10) | \$ — | \$ (7) | \$ (7) |

The Company uses the market and income approach to determine the fair value of marketable securities. U.S. government securities and equity mutual funds are Level 1 as the fair value is based on quoted prices in active markets. The remaining marketable securities instruments are Level 2 as the fair value is based on standard valuation models that calculate values from observable inputs such as quoted interest rates, yield curves, credit ratings of the security and other observable market information.

The Company uses the market and income approaches to determine the fair value of derivative instruments. The fair value for fuel hedge call options is determined utilizing an option pricing model that uses inputs that are readily available in active markets or can be derived from information available in active markets. In addition, the fair value considers exposure to credit losses in the event of non-performance by counterparties. Interest rate swap agreements are Level 2 as the fair value of these contracts is determined based on the difference between the fixed interest rate in the agreements and the observable LIBOR-based interest forward rates at period end, multiplied by the total notional value.

Activity and Maturities for Marketable Securities

Unrealized losses from marketable securities are primarily attributable to changes in interest rates. Management does not believe any remaining losses represent other-than-temporary impairments based on the Company's evaluation of available evidence as of December 31, 2019.

Proceeds from sales of marketable securities were \$1.7 billion, \$1.1 billion and \$1.4 billion in 2019, 2018, and 2017.

Maturities for marketable securities (in millions):

| December 31, 2019 | Cost Basis | Fair Value |
|---------------------------------------|-------------------|-------------------|
| Due in one year or less | \$ 164 | \$ 165 |
| Due after one year through five years | 1,102 | 1,114 |
| Due after five years through 10 years | 16 | 16 |
| Total | \$ 1,282 | \$ 1,295 |

Fair Value of Other Financial Instruments

The Company used the following methods and assumptions to determine the fair value of financial instruments that are not recognized at fair value on the consolidated balance sheets.

Cash and Cash Equivalents: Carried at amortized costs which approximate fair value.

Debt: Debt assumed in the acquisition of Virgin America was subject to a non-recurring fair valuation adjustment as part of purchase price accounting. The adjustment is amortized over the life of the associated debt. All other fixed-rate debt is carried at cost. To estimate the fair value of all fixed-rate debt as of December 31, 2019, the Company uses the income approach by discounting cash flows using borrowing rates for comparable debt over the weighted life of the outstanding debt. The estimated fair value of the fixed-rate debt is Level 3 as certain inputs used are unobservable.

Fixed-rate debt on the consolidated balance sheet and the estimated fair value of long-term fixed-rate debt (in millions):

| | December 31, 2019 | December 31, 2018 |
|---|--------------------------|--------------------------|
| Fixed rate debt at cost | \$ 473 | \$ 639 |
| Non-recurring purchase price accounting fair value adjustment | 2 | 3 |
| Total fixed rate debt | \$ 475 | \$ 642 |
| Estimated fair value | \$ 483 | \$ 641 |

NOTE 5. LONG-TERM DEBT

Long-term debt obligations (in millions):

| | 2019 | 2018 |
|--|-----------------|-----------------|
| Fixed-rate notes payable due through 2029 | \$ 475 | \$ 642 |
| Variable-rate notes payable due through 2029 | 1,032 | 1,473 |
| Less debt issuance costs | (8) | (12) |
| Total debt | 1,499 | 2,103 |
| Less current portion | 235 | 486 |
| Long-term debt, less current portion | \$ 1,264 | \$ 1,617 |
| Weighted-average fixed-interest rate | 3.3 % | 4.1 % |
| Weighted-average variable-interest rate | 2.9 % | 3.9 % |

Approximately \$717 million of the Company's total variable-rate notes payable are effectively fixed via interest rate swaps at December 31, 2019, bringing the weighted-average interest rate for the full debt portfolio to 3%.

During 2019, the Company's total debt decreased \$604 million, primarily due to payments of \$1.1 billion, including the prepayment of \$779 million of debt. These reductions in debt were offset by the addition of secured debt financing from multiple lenders of \$450 million. All outstanding debt is secured by aircraft.

The Company's variable-rate debt bears interest at a floating rate per annum equal to a margin plus the three or six-month LIBOR in effect at the commencement of each three or six-month period, as applicable. As of December 31, 2019, none of the Company's borrowings were restricted by financial covenants.

Long-term debt principal payments for the next five years and thereafter (in millions):

| | Total |
|---------------------------------|-----------------|
| 2020 | \$ 235 |
| 2021 | 281 |
| 2022 | 243 |
| 2023 | 173 |
| 2024 | 153 |
| Thereafter | 420 |
| Total principal payments | \$ 1,505 |

Bank Line of Credit

The Company has three credit facilities with availability totaling \$516 million. All three facilities have variable interest rates based on LIBOR plus a specified margin. One credit facility for \$250 million expires in June 2021 and is secured by aircraft. A second credit facility for \$116 million expires in July 2020, with a mechanism for annual renewal, and is secured by aircraft. A third credit facility for \$150 million expires in March 2022 and is secured by certain accounts receivable, spare engines, spare parts and ground service equipment. The Company has secured letters of credit against the \$116 million facility, but has no plans to borrow using either of the two other facilities. All three credit facilities have a requirement to maintain a minimum unrestricted cash and marketable securities balance of \$500 million. The Company was in compliance with this covenant at December 31, 2019.

NOTE 6. LEASES

In 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to recognize assets and liabilities for certain operating leases. Under the new standard, a lessee must recognize a liability on the balance sheet representing the lease payments owed, and a lease asset representing its right to use the underlying asset for the lease term. In 2018, the FASB issued ASU 2018-11, "Targeted Improvements - Leases (Topic 842)," which amended Topic 842 to provide a transition method that would not require adjusting comparative period financial information.

The Company transitioned to the new lease accounting standard effective January 1, 2019 utilizing the alternative transition method. Upon transition, the Company recorded a cumulative-effect adjustment to the opening balance of retained earnings of \$3 million. The new standard eliminated build-to-suit lease accounting guidance and resulted in the derecognition of build-to-suit assets and liabilities of approximately \$150 million each.

The Company elected certain practical expedients under the standard, including the practical expedient allowing a policy election to exclude from recognition short-term lease assets and lease liabilities for leases with an initial term of 12 months or less. Such expense was not material for the twelve months ended December 31, 2019. Additionally, the Company elected the available package of practical expedients allowing for no reassessment of lease classification for existing leases, no reassessment of expired contracts, and no reassessments of initial direct costs for existing leases.

The Company has five asset classes for operating leases: aircraft, capacity purchase arrangements for aircraft operated by third-party carriers (CPA aircraft), airport and terminal facilities, corporate real estate and other equipment. All capitalized lease assets have been recorded on the consolidated balance sheet as of December 31, 2019 as Operating lease assets, with the corresponding liabilities recorded as Operating lease liabilities. Consistent with past accounting, operating rent expense is recognized on a straight-line basis over the term of the lease.

At December 31, 2019, the Operating lease assets balance by asset class was as follows (in millions):

| | December 31, 2019 |
|-------------------------------------|--------------------------|
| Aircraft | \$ 1,049 |
| CPA Aircraft | 596 |
| Airport and terminal facilities | 18 |
| Corporate real estate and other | 48 |
| Total Operating lease assets | \$ 1,711 |

Aircraft

At December 31, 2019, Alaska had operating leases for 10 Boeing 737, 61 Airbus, and Horizon had operating leases for seven Bombardier Q400 aircraft. Remaining lease terms for these aircraft extend up to 12 years, some with options to extend, subject to negotiation at the end of the term. As extension is not certain, and rates are highly likely to be renegotiated, the extended term is only capitalized when it is reasonably determinable. While aircraft rent is primarily fixed, certain leases contain rental adjustments throughout the lease term which would be recognized as variable expense as incurred. Variable lease expense for aircraft was \$4 million for the twelve months ended December 31, 2019.

Capacity purchase agreements with aircraft (CPA aircraft)

At December 31, 2019, Alaska had CPAs with two carriers, including the Company's wholly-owned subsidiary, Horizon. Horizon sells 100% of its capacity under a CPA with Alaska. Alaska also has a CPA with SkyWest covering 32 E175 aircraft to fly certain routes in the Lower 48 and Canada. Under these agreements, Alaska pays the carriers an amount which is based on a determination of their cost of operating those flights and other factors intended to approximate market rates for those services. As Horizon is a wholly-owned subsidiary, intercompany leases between Alaska and Horizon have not been recognized under the standard.

Remaining lease terms for CPA aircraft range from 7.5 years to 11 years. Financial arrangements of the CPAs include a fixed component, representing the costs to operate each aircraft and is capitalized under the new lease accounting standard. CPAs also include variable rent based on actual levels of flying, which is expensed as incurred. Variable lease expense for CPA aircraft for the twelve months ended December 31, 2019 was not material.

Airport and terminal facilities

The Company leases ticket counters, gates, cargo and baggage space, ground equipment, office space and other support areas at numerous airports. For this asset class, the Company has elected to combine lease and non-lease components. The majority of airport and terminal facility leases are not capitalized because they do not meet the definition of controlled assets under the standard, or because the lease payments are entirely variable. For airports where leased assets are identified, and where the contract includes fixed lease payments, operating lease assets and lease liabilities have been recorded. The Company is also commonly responsible for maintenance, insurance and other facility-related expenses and services under these agreements. These costs are recognized as variable expense in the period incurred. Airport and terminal facilities variable lease expense was \$322 million for the twelve months ended December 31, 2019.

Starting in 2018, the Company leased 12 airport slots at LaGuardia Airport and eight airport slots at Reagan National Airport to a third party. For these leases, the Company recorded \$13 million of lease income during the twelve months ended December 31, 2019.

Corporate real estate and other leases

Leased corporate real estate is primarily for office space in hub cities, data centers, land leases, and reservation centers. For this asset class, the Company has elected to combine lease and non-lease components under the standard. Other leased assets are comprised of other ancillary contracts and items including leased flight simulators and spare engines. Variable lease expense related to corporate real estate and other leases for the twelve months ended December 31, 2019 was \$10 million.

Components of Lease Expense

The impact of leases, including variable lease cost, on earnings for the twelve months ended December 31, 2019 was as follows (in millions):

| | Classification | 2019 |
|---------------------------------|--------------------------------|---------------|
| Expense | | |
| Aircraft | Aircraft rent | \$ 246 |
| CPA Aircraft | Aircraft rent | 79 |
| Airport and terminal facilities | Landing fees and other rentals | 324 |
| Corporate real estate and other | Landing fees and other rentals | 19 |
| Total lease expense | | \$ 668 |
| Revenue | | |
| Lease income | Cargo and other revenues | (13) |
| Net lease impact | | \$ 655 |

Supplemental Cash Flow Information

During the year ended December 31, 2019, the Company paid \$347 million for capitalized operating leases. The Company also acquired \$176 million of operating lease assets in exchange for assumption of the same total of operating lease liabilities, inclusive of lease extensions.

Lease Term and Discount Rate

As most leases do not provide an implicit interest rate, the Company generally utilizes the incremental borrowing rate (IBR) based on information available at the commencement date of the lease to determine the present value of lease payments. The weighted average IBR and weighted average remaining lease term (in years) for all asset classes were as follows at December 31, 2019.

| | Weighted Average IBR | Weighted Average Remaining Lease term |
|----------------------------------|----------------------|---------------------------------------|
| Aircraft | 4.0 % | 7.0 |
| CPA Aircraft | 4.3 % | 9.2 |
| Airports and terminal facilities | 4.1 % | 10.0 |
| Corporate real estate and other | 4.2 % | 34.9 |

Maturities of Lease Liabilities

Future minimum lease payments under non-cancellable leases as of December 31, 2019 (in millions):

| | Aircraft | CPA Aircraft | Airport and Terminal Facilities | Corporate Real Estate and Other |
|-----------------------------|-----------------|---------------|---------------------------------|---------------------------------|
| 2020 | \$ 245 | \$ 79 | \$ 3 | \$ 8 |
| 2021 | 216 | 79 | 2 | 6 |
| 2022 | 190 | 79 | 2 | 5 |
| 2023 | 133 | 79 | 2 | 5 |
| 2024 | 81 | 79 | 2 | 5 |
| Thereafter | 331 | 329 | 11 | 74 |
| Total Lease Payments | \$ 1,196 | \$ 724 | \$ 22 | \$ 103 |
| Less: Imputed interest | (151) | (128) | (4) | (54) |
| Total | \$ 1,045 | \$ 596 | \$ 18 | \$ 49 |

Disclosures for Periods Prior to Adoption of Topic 842

As of December 31, 2018, the Company had commitments for aircraft and facility leases. Aircraft lease commitments include future obligations for the Company's operating airlines – Alaska and Horizon – as well as aircraft leases operated by third parties. At December 31, 2018, Alaska had lease contracts for 10 B737 aircraft, 61 Airbus aircraft, 32 E175 aircraft with SkyWest, and Horizon had lease contracts for nine Bombardier Q400 aircraft.

Facility lease commitments primarily include airport and terminal facilities and building leases. Total rent expense for aircraft and facility leases was \$19 million and \$552 million in 2018 and 2017.

Future minimum lease payments under noncancelable operating leases were as follows as of December 31, 2018 (in millions):

| | Aircraft Leases | Facility Leases |
|--------------|-----------------|-----------------|
| 2019 | \$ 350 | \$ 133 |
| 2020 | 320 | 124 |
| 2021 | 286 | 113 |
| 2022 | 262 | 94 |
| 2023 | 208 | 26 |
| Thereafter | 847 | 122 |
| Total | \$ 2,273 | \$ 612 |

NOTE 7. INCOME TAXES

Deferred Income Taxes

Deferred income taxes reflect the impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and such amounts for tax purposes. The Company has a net deferred tax liability, primarily due to differences in depreciation rates for federal income tax purposes and for financial reporting purposes.

Deferred tax (assets) and liabilities comprise the following (in millions):

| | 2019 | 2018 |
|--------------------------------------|----------------|---------------|
| Excess of tax over book depreciation | \$ 1,233 | \$ 1,066 |
| Intangibles - net | 16 | 15 |
| Operating lease liabilities | 416 | — |
| Other - net | 58 | 43 |
| Deferred tax liabilities | <u>1,723</u> | <u>1,124</u> |
| Mileage Plan™ | (337) | (315) |
| Inventory obsolescence | (15) | (15) |
| Employee benefits | (179) | (172) |
| Acquired net operating losses | (13) | (64) |
| Operating lease assets | (417) | — |
| Other - net | (48) | (48) |
| Deferred tax assets | <u>(1,009)</u> | <u>(614)</u> |
| Valuation allowance | 1 | 2 |
| Net deferred tax liabilities | <u>\$ 715</u> | <u>\$ 512</u> |

At December 31, 2019, the Company had federal NOLs of approximately \$45 million that expire beginning in 2032 and continuing through 2036, and state NOLs of approximately \$55 million that expire beginning in 2029 and continuing through 2036.

Virgin America experienced multiple “ownership changes” as defined in Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”), the most recent being its acquisition by the Company. Section 382 of the Code imposes an annual limitation on the utilization of pre-ownership change NOLs. Any unused annual limitation may, subject to certain limits, be carried over to later years. The combined Company’s ability to use the NOLs will also depend on the amount of taxable income generated in future periods.

Valuation allowances are provided to reduce the related deferred income tax assets to an amount which will, more likely than not, be realized. The valuation allowance was not material at both December 31, 2019 and December 31, 2018.

Components of Income Tax Expense

The components of income tax expense are as follows (in millions):

| | 2019 | 2018 | 2017 |
|---|---------------|---------------|---------------|
| Current income tax expense (benefit): | | | |
| Federal | \$ 26 | \$ (5) | \$ 127 |
| State | 13 | 9 | 35 |
| Total current income tax expense | <u>39</u> | <u>4</u> | <u>162</u> |
| Deferred income tax expense (benefit): | | | |
| Federal | 175 | 125 | (3) |
| State | 33 | 19 | 40 |
| Total deferred income tax expense (benefit) | <u>208</u> | <u>144</u> | <u>37</u> |
| Income tax expense | <u>\$ 247</u> | <u>\$ 148</u> | <u>\$ 199</u> |

Income Tax Rate Reconciliation

Income tax expense reconciles to the amount computed by applying the 2019 U.S. federal rate of 21% to income before income tax and for deferred taxes as follows (in millions):

| | 2019 | 2018 | 2017 |
|--------------------------|----------|--------|----------|
| Income before income tax | \$ 1,016 | \$ 585 | \$ 1,159 |
| Expected tax expense | 213 | 123 | 406 |
| Nondeductible expenses | 9 | 9 | 5 |
| State income taxes | 36 | 21 | 28 |
| State income sourcing | 1 | — | 9 |
| Tax law changes | (9) | (7) | (237) |
| Other - net | (3) | 2 | (12) |
| Actual tax expense | \$ 247 | \$ 148 | \$ 199 |
| Effective tax rate | 24.3 % | 25.3 % | 17.2 % |

As a result of the ASC 606 full retrospective adoption, 2017 tax expense increased by \$26 million.

As a result of tax changes signed into law during 2017, with final regulations issued in 2019, the Company recorded a deferred tax benefit of \$9 million in the current year.

In 2017, adjustments were made to the Company's position on income sourcing in various states due to updated guidance from state taxing authorities. The impact of this guidance is reflected as an increase in income tax expense of approximately \$9 million for the year ended December 31, 2017.

Uncertain Tax Positions

The Company has identified its federal tax return and its state tax returns in Alaska, Oregon and California as "major" tax jurisdictions. A summary of the Company's jurisdictions and the periods that are subject to examination are as follows:

| Jurisdiction | Period |
|--------------|--------------|
| Federal | 2007 to 2018 |
| Alaska | 2015 to 2018 |
| California | 2007 to 2018 |
| Oregon | 2003 to 2018 |

Certain tax years are open to the extent of net operating loss carryforwards.

Changes in the liability for gross unrecognized tax benefits during 2019, 2018 and 2017 are as follows (in millions):

| | 2019 | 2018 | 2017 |
|---|-------|-------|-------|
| Balance at January 1, | \$ 40 | \$ 43 | \$ 40 |
| Additions related to prior years | — | 1 | 16 |
| Releases related to prior years | (1) | (4) | (2) |
| Additions related to current year activity | 2 | 2 | 2 |
| Releases due to settlements | — | (1) | (11) |
| Releases due to lapse of statute of limitations | (1) | (1) | (2) |
| Balance at December 31, | \$ 40 | \$ 40 | \$ 43 |

As of December 31, 2019, the Company had \$40 million of accrued tax contingencies, of which \$34 million, if fully recognized, would decrease the effective tax rate. As of December 31, 2019, 2018 and 2017, the Company has accrued interest and penalties, net of federal income tax benefit, of \$7 million, \$6 million, and \$5 million. In 2019, 2018, and 2017, the

Company recognized an expense of \$1 million, \$1 million, and \$2 million for interest and penalties, net of federal income tax benefit. At December 31, 2019, the Company has unrecognized tax benefits recorded as a liability and some reducing deferred tax assets. The Company's reserves for uncertain tax positions is unchanged in 2019 after statute lapses on reserves and current year activity. These uncertain tax positions could change as a result of the Company's ongoing audits, settlement of issues, new audits and status of other taxpayer court cases. The Company cannot predict the timing of these actions. Due to the positions being taken in various jurisdictions, the amounts currently accrued are the Company's best estimate as of December 31, 2019.

NOTE 8. EMPLOYEE BENEFIT PLANS

Four qualified defined-benefit plans, one non-qualified defined-benefit plan, and seven defined-contribution retirement plans cover various employee groups of Alaska, Horizon and McGee Air Services.

The defined-benefit plans provide benefits based on an employee's term of service and average compensation for a specified period of time before retirement. The qualified defined-benefit pension plans are closed to new entrants.

Accounting standards require recognition of the overfunded or underfunded status of an entity's defined-benefit pension and other postretirement plan as an asset or liability in the consolidated financial statements and requires recognition of the funded status in AOCL.

Qualified Defined-Benefit Pension Plans

The Company's four qualified defined-benefit pension plans are funded as required by the Employee Retirement Income Security Act of 1974. The defined-benefit plan assets consist primarily of marketable equity and fixed-income securities. The work groups covered by qualified defined-benefit pension plans include salaried employees, pilots, clerical, office, passenger service employees, mechanics and related craft employees. The Company uses a December 31 measurement date for these plans. All plans are closed to new entrants.

Weighted average assumptions used to determine benefit obligations:

The rates below vary by plan and related work group.

| | 2019 | 2018 |
|--------------------------------|----------------|----------------|
| Discount rates | 3.33% to 3.47% | 4.37% to 4.46% |
| Rate of compensation increases | 2.11% to 5.44% | 2.11% to 3.50% |

Weighted average assumptions used to determine net periodic benefit cost:

The rates below vary by plan and related work group.

| | 2019 | 2018 | 2017 |
|---|----------------|-----------------|----------------|
| Discount rates | 4.37% to 4.46% | 3.69% to 3.78% | 4.29% to 4.50% |
| Expected return on plan assets | 4.25% to 5.50% | 4.25% to 5.50% | 5.50% to 6.00% |
| Rate of compensation increases ^(a) | 2.11% to 3.50% | 2.11% to 16.51% | 2.12% to 2.59% |

(a) Significant rate of compensation increase in 2018 is due to the new contract with our Mainline pilots, which was executed at the end of 2017.

The discount rates are determined using current interest rates earned on high-quality, long-term bonds with maturities that correspond with the estimated cash distributions from the pension plans. At December 31, 2019, the Company selected discount rates for each of the plans using a pool of higher-yielding bonds estimated to be more reflective of settlement rates, as management has taken steps to ultimately terminate or settle plans that are frozen and move toward freezing benefits in active plans in the future. In determining the expected return on plan assets, the Company assesses the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class is then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

Plan assets are invested in common commingled trust funds invested in equity and fixed income securities and in certain real estate assets. The target and actual asset allocation of the funds in the qualified defined-benefit plans, by asset category, are as follows:

| | Salaried Plan ^(a) | | | All other plans | | |
|----------------------------|------------------------------|-------|-------|-----------------|-------|-------|
| | Target | 2019 | 2018 | Target | 2019 | 2018 |
| Asset category: | | | | | | |
| Domestic equity securities | 2% - 12% | 7 % | 6 % | 36% - 46% | 41 % | 28 % |
| Non-U.S. equity securities | 0% - 5% | 3 % | 3 % | 13% - 23% | 18 % | 12 % |
| Fixed income securities | 85% - 95% | 90 % | 91 % | 26% - 46% | 35 % | 53 % |
| Real estate | — % | — % | — % | 0% - 10% | 6 % | 7 % |
| Plan assets | | 100 % | 100 % | | 100 % | 100 % |

(a) As our Salaried Plan is frozen and fully funded, our investment strategies differ significantly from that of our other outstanding plans. Investments are in lower-risk securities, with earnings designed to maintain a fully-funded status.

The Company's investment policy focuses on achieving maximum returns at a reasonable risk for pension assets over a full market cycle. The Company determines the strategic allocation between equities, fixed income and real estate based on current funded status and other characteristics of the plans. As the funded status improves, the Company increases the fixed income allocation of the portfolio and decreases the equity allocation. Actual asset allocations are reviewed regularly and periodically rebalanced as appropriate.

Plan assets invested in common commingled trust funds are fair valued using the net asset values of these funds to determine fair value as allowed using the practical expedient method outlined in the accounting standards. Fair value estimates for real estate are calculated using the present value of expected future cash flows based on independent appraisals, local market conditions and current and projected operating performance.

Plan assets by fund category (in millions):

| | 2019 | 2018 | Fair Value Hierarchy |
|---|----------|----------|----------------------|
| Fund type: | | | |
| U.S. equity market fund | \$ 773 | \$ 431 | 1 |
| Non-U.S. equity fund | 344 | 183 | 1 |
| Credit bond index fund | 1,009 | 1,135 | 1 |
| Plan assets in common commingled trusts | \$ 2,126 | \$ 1,749 | |
| Real estate | 102 | 104 | (a) |
| Cash equivalents | 11 | 5 | 1 |
| Total plan assets | \$ 2,239 | \$ 1,858 | |

(a) In accordance with Subtopic 820-10, certain investments that are measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy.

The following table sets forth the status of the qualified defined-benefit pension plans (in millions):

| | 2019 | 2018 |
|---|-----------------|-----------------|
| Projected benefit obligation (PBO) | | |
| Beginning of year | \$ 2,225 | \$ 2,387 |
| Service cost | 42 | 48 |
| Interest cost | 89 | 79 |
| Actuarial (gain)/loss | 359 | (191) |
| Benefits paid | (113) | (98) |
| End of year | <u>\$ 2,602</u> | <u>\$ 2,225</u> |
| Plan assets at fair value | | |
| Beginning of year | \$ 1,858 | \$ 2,083 |
| Actual return on plan assets | 429 | (127) |
| Employer contributions | 65 | — |
| Benefits paid | (113) | (98) |
| End of year | <u>\$ 2,239</u> | <u>\$ 1,858</u> |
| Unfunded status | <u>\$ (363)</u> | <u>\$ (367)</u> |
| Percent funded | <u>86 %</u> | <u>84 %</u> |

The accumulated benefit obligation for the combined qualified defined-benefit pension plans was \$2.4 billion and \$2.1 billion at December 31, 2019 and 2018.

The amounts recognized in the consolidated balance sheets (in millions):

| | 2019 | 2018 |
|--|---------------|---------------|
| Accrued benefit liability-long term | \$ 412 | \$ 392 |
| Plan assets-long term (within Other noncurrent assets) | (49) | (25) |
| Total liability recognized | <u>\$ 363</u> | <u>\$ 367</u> |

The amounts not yet reflected in net periodic benefit cost and included in AOCL (in millions):

| | 2019 | 2018 |
|------------------------------------|---------------|---------------|
| Prior service credit | \$ (6) | \$ (8) |
| Net loss | 595 | 607 |
| Amount recognized in AOCL (pretax) | <u>\$ 589</u> | <u>\$ 599</u> |

The expected amortization of prior service credit and net loss from AOCL in 2020 is \$1 million and \$35 million for the qualified defined-benefit pension plans.

Net pension expense for the qualified defined-benefit plans included the following components (in millions):

| | 2019 | 2018 | 2017 |
|--------------------------------------|--------------|--------------|--------------|
| Service cost | \$ 42 | \$ 48 | \$ 39 |
| Interest cost | 89 | 79 | 74 |
| Expected return on assets | (95) | (107) | (106) |
| Amortization of prior service credit | (1) | (1) | (1) |
| Recognized actuarial loss | 37 | 33 | 26 |
| Net pension expense | <u>\$ 72</u> | <u>\$ 52</u> | <u>\$ 32</u> |

There are no current statutory funding requirements for the Company's plans in 2020.

Future benefits expected to be paid over the next ten years under the qualified defined-benefit pension plans from the assets of those plans (in millions):

| | Total |
|------------|--------------|
| 2020 | \$ 115 |
| 2021 | 118 |
| 2022 | 134 |
| 2023 | 137 |
| 2024 | 137 |
| 2025– 2029 | 800 |

Nonqualified Defined-Benefit Pension Plan

Alaska also maintains an unfunded, noncontributory defined-benefit plan for certain elected officers. This plan uses a December 31 measurement date. The assumptions used to determine benefit obligations and the net period benefit cost for the nonqualified defined-benefit pension plan are similar to those used to calculate the qualified defined-benefit pension plan. The plan's unfunded status, PBO and accumulated benefit obligation are immaterial. The net pension expense in prior year and expected future expense is also immaterial.

Post-retirement Medical Benefits

The Company allows certain retirees to continue their medical, dental and vision benefits by paying all or a portion of the active employee plan premium until eligible for Medicare, currently age 65. This results in a subsidy to retirees, because the premiums received by the Company are less than the actual cost of the retirees' claims. The accumulated post-retirement benefit obligation for this subsidy is unfunded. The accumulated post-retirement benefit obligation was \$129 million and \$82 million at December 31, 2019 and 2018. The net periodic benefit cost was not material in 2019 or 2018.

Defined-Contribution Plans

The seven defined-contribution plans are deferred compensation plans under section 401(k) of the Internal Revenue Code. All of these plans require Company contributions. Total expense for the defined-contribution plans was \$132 million, \$126 million and \$103 million in 2019, 2018, and 2017.

The Company also has a noncontributory, unfunded defined-contribution plan for certain elected officers of the Company who are ineligible for the nonqualified defined-benefit pension plan. Amounts recorded as liabilities under the plan are not material to the consolidated balance sheets at December 31, 2019 and 2018.

Pilot Long-term Disability Benefits

Alaska maintains a long-term disability plan for its pilots. The long-term disability plan does not have a service requirement. Therefore, the liability is calculated based on estimated future benefit payments associated with pilots that were assumed to be disabled on a long-term basis as of December 31, 2019 and does not include any assumptions for future disability. The liability includes the discounted expected future benefit payments and medical costs. The total liability was \$45 million and \$25 million, which was recorded net of a prefunded trust account of \$6 million and \$3 million, and included in long-term other liabilities on the consolidated balance sheets as of December 31, 2019 and December 31, 2018.

Employee Incentive-Pay Plans

The Company has employee incentive plans that pay employees based on certain financial and operational metrics. These metrics are set and approved annually by the Compensation Committee of the Board of Directors. The aggregate expense under these plans in 2019, 2018 and 2017 was \$163 million, \$147 million and \$135 million. The incentive plans are summarized below.

- *Performance-Based Pay* (PBP) is a program that rewards the majority of Alaska and Horizon employees. The program is based on various metrics that adjust periodically, including those related to Air Group profitability, safety, Mileage Plan™ and credit card growth, achievement of unit-cost goals and employee engagement as measured by brand strength.

- The *Operational Performance Rewards Program* entitles the majority of Alaska and Horizon employees to quarterly payouts of up to \$450 per person if certain monthly operational and customer service objectives are met.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Future minimum payments for commitments as of December 31, 2019 (in millions):

| | Aircraft Commitments ^(a) | Capacity Purchase Agreements ^(b) | Aircraft Maintenance Deposits |
|--------------|-------------------------------------|---|-------------------------------|
| 2020 | \$ 531 | \$ 145 | \$ 73 |
| 2021 | 487 | 166 | 62 |
| 2022 | 347 | 174 | 51 |
| 2023 | 206 | 179 | 26 |
| 2024 | 31 | 184 | 6 |
| Thereafter | 26 | 880 | 2 |
| Total | \$ 1,628 | \$ 1,728 | \$ 220 |

(a) Includes non-cancelable contractual commitments for aircraft and engines, buyer furnished equipment, and aircraft maintenance and parts management.

(b) Includes all non-aircraft lease costs associated with capacity purchase agreements.

Aircraft Commitments

Aircraft purchase commitments include non-cancelable contractual commitments for aircrafts and engines. As of December 31, 2019, Alaska had commitments to purchase 32 Boeing 737 MAX9 aircraft with deliveries in 2020 through 2023. Future minimum contractual payments for these aircraft have been updated to reflect the most current anticipated delivery timing for 737 MAX aircraft, which has been delayed as a result of the grounding order mandated by the FAA on March 13, 2019, and is subject to change. Horizon also has commitments to purchase three E175 aircraft with deliveries in 2023 and has cancelable purchase commitments for 30 Airbus A320neo aircraft with deliveries from 2023 through 2025. In addition, Alaska has options to purchase 37 737 MAX aircraft and Horizon has options to purchase 30 E175 aircraft. Alaska has an option to increase capacity flown by Skywest with eight additional E175 aircraft with deliveries in 2022. The cancelable purchase commitments and option payments are not reflected in the table above.

Aircraft Maintenance and Parts Management

Through its acquisition of Virgin America, the Company has a separate maintenance-cost-per-hour contract for management and repair of certain rotatable parts to support Airbus airframe and engine maintenance and repair. In 2017, Alaska entered into a similar contract for maintenance on its B737-800 aircraft engines. These agreements require monthly payments based upon utilization, such as flight hours, cycles and age of the aircraft, and, in turn, the agreement transfers certain risks to the third-party service provider. There are minimum payments under both agreements, which are reflected in the table above. Accordingly, payments could differ materially based on actual aircraft utilization.

Aircraft Maintenance Deposits

Certain Airbus leases include contractually required maintenance deposit payments to the lessor, which collateralize the lessor for future maintenance events should the Company not perform required maintenance. Most of the lease agreements provide that maintenance deposits are reimbursable upon completion of the major maintenance event in an amount equal to the lesser of (i) the amount qualified for reimbursement from maintenance deposits held by the lessor associated with the specific major maintenance event or (ii) the qualifying costs related to the specific major maintenance event.

Contingencies

The Company is a party to routine litigation matters incidental to its business and with respect to which no material liability is expected. Liabilities for litigation related contingencies are recorded when a loss is determined to be probable and estimable.

In 2015, three flight attendants filed a class action lawsuit seeking to represent all Virgin America flight attendants for damages based on alleged violations of California and City of San Francisco wage and hour laws. The court certified a class of

approximately 1,800 flight attendants in November 2016. The Company believes the claims in this case are without factual and legal merit.

In July 2018, the Court granted in part Plaintiffs' motion for summary judgment, finding Virgin America, and Alaska Airlines, as a successor-in-interest to Virgin America, responsible for various damages and penalties sought by the class members. On February 4, 2019, the Court entered final judgment against Virgin America and Alaska Airlines in the amount of approximately \$78 million. It did not award injunctive relief against Alaska Airlines.

The Company is seeking an appellate court ruling that the California laws on which the judgment is based are invalid as applied to national airlines pursuant to the U.S. Constitution and federal law and for other employment law and improper class certification reasons. The Company remains confident that a higher court will respect the federal preemption principles that were enacted to shield inter-state common carriers from a patchwork of state and local wage and hour regulations such as those at issue in this case and agree with the Company's other bases for appeal. For these reasons, no loss has been accrued.

The Company is involved in other litigation around the application of state and local employment laws, like many air carriers. Our defenses are similar to those identified above, including that the state and local laws are preempted by federal law and are unconstitutional because they impede interstate commerce. None of these additional disputes are material.

NOTE 10. SHAREHOLDERS' EQUITY

Dividends

During 2019, the Board of Directors declared dividends of \$1.40 per share. The Company paid dividends of \$173 million, \$158 million and \$148 million to shareholders of record during 2019, 2018 and 2017.

Subsequent to year-end, the Board of Directors declared a quarterly cash dividend of \$0.375 per share to be paid in March 2020 to shareholders of record as of February 18, 2020. This is a 7% increase from the most recent quarterly dividend of \$0.35 per share.

Common Stock Repurchase

In August 2015, the Board of Directors authorized a \$1 billion share repurchase program. As of December 31, 2019, the Company has repurchased 7.1 million shares for \$513 million under this program.

At December 31, 2019, the Company held 8,811,866 shares in treasury. Management does not anticipate retiring common shares held in treasury for the foreseeable future.

Share repurchase activity (in millions, except shares):

| | 2019 | | 2018 | | 2017 | |
|---------------------------------------|-----------|--------|---------|--------|---------|--------|
| | Shares | Amount | Shares | Amount | Shares | Amount |
| 2015 Repurchase Program – \$1 billion | 1,192,820 | \$ 75 | 776,186 | \$ 50 | 981,277 | \$ 75 |

Accumulated Other Comprehensive Loss (AOCL)

AOCL consisted of the following (in millions, net of tax):

| | 2019 | 2018 |
|--------------------------------------|-----------------|-----------------|
| Related to marketable securities | \$ 9 | \$ (11) |
| Related to employee benefit plans | (469) | (440) |
| Related to interest rate derivatives | (5) | 3 |
| | <u>\$ (465)</u> | <u>\$ (448)</u> |

NOTE 11. SPECIAL ITEMS

In 2019, the Company recognized special items of \$44 million for merger-related costs associated with its acquisition of Virgin America. Costs classified as merger-related are directly attributable to merger activities.

In 2018, the Company recognized \$87 million in merger-related costs. The Company incurred a one-time settlement fee of \$20 million for the termination of an existing maintenance services agreement and subsequently entered into a new services agreement that provides more flexibility for the timing and scope of engine work. Additionally, the Company incurred \$25 million for one-time bonuses paid to employees as a result of tax reform. These charges were recognized as special charges and are included in the Special items - other line on our consolidated statements of operations.

In 2017, the Company recognized \$116 million in merger-related costs. The Company also recognized a special tax benefit of \$237 million due to the remeasurement of net deferred tax liabilities as a result of the Tax Cuts and Jobs Act signed into law on December 22, 2017, partially offset by certain state tax law enactments.

The Company has recognized \$364 million in merger-related costs since the acquisition of Virgin America in December 2016.

The following breaks down merger-related costs incurred in 2019, 2018 and 2017 (in millions):

| | 2019 | 2018 | 2017 |
|---|--------------|--------------|---------------|
| Consulting and professional services | \$ 18 | \$ 45 | \$ 52 |
| Employee-related costs ^(a) | 15 | 13 | 41 |
| Legal and accounting fees | 1 | 1 | 3 |
| Other merger-related costs ^(b) | 10 | 28 | 20 |
| Total Merger-related Costs | <u>\$ 44</u> | <u>\$ 87</u> | <u>\$ 116</u> |

(a) Employee-related costs consist primarily of vacation balance true-ups, severance, retention bonuses, and training and skill development.

(b) Other merger-related costs consist primarily of costs for marketing and advertising, IT, employee appreciation and company sponsored events, moving expenses, supplies, and other immaterial expenses.

NOTE 12. STOCK-BASED COMPENSATION PLANS

The Company has various equity incentive plans under which it may grant stock awards to directors, officers and employees. The Company also has an employee stock purchase plan.

The table below summarizes the components of total stock-based compensation (in millions):

| | 2019 | 2018 | 2017 |
|---|--------------|--------------|--------------|
| Stock options | \$ 3 | \$ 3 | \$ 3 |
| Stock awards | 21 | 23 | 24 |
| Deferred stock awards | 1 | 1 | 1 |
| Employee stock purchase plan | 11 | 9 | 6 |
| Stock-based compensation | <u>\$ 36</u> | <u>\$ 36</u> | <u>\$ 34</u> |
| Tax benefit related to stock-based compensation | \$ 9 | \$ 9 | \$ 13 |

Unrecognized stock-based compensation for non-vested options and awards and the weighted-average period the expense will be recognized (in millions):

| | Amount | Weighted-Average Period |
|---------------------------------------|--------------|-------------------------|
| Stock options | \$ 4 | 1.3 |
| Stock awards | 20 | 1.5 |
| Unrecognized stock-based compensation | <u>\$ 24</u> | <u>1.5</u> |

The Company is authorized to issue 17 million shares of common stock under these plans, of which 8,627,341 shares remain available for future grants of either options or stock awards as of December 31, 2019.

Stock Options

Stock options to purchase common stock are granted at the fair market value of the stock on the date of grant. The stock options granted have terms of up to ten years.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants:

| | 2019 | 2018 | 2017 |
|--|----------|----------|----------|
| Expected volatility | 30 % | 30 % | 51 % |
| Expected term | 6 years | 6 years | 6 years |
| Risk-free interest rate | 2.41 % | 2.61 % | 2.04 % |
| Expected dividend yield | 2.09 % | 1.94 % | 1.10 % |
| Weighted-average grant date fair value per share | \$ 16.84 | \$ 17.18 | \$ 41.19 |
| Estimated fair value of options granted (millions) | \$ 4 | \$ 1 | \$ 4 |

The expected market price volatility and expected term are based on historical results. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected dividend yield is based on the estimated weighted average dividend yield over the expected term. The expected forfeiture rates are based on historical experience.

The tables below summarize stock option activity for the year ended December 31, 2019:

| | Shares | Weighted-Average Exercise Price Per Share | Weighted-Average Contractual Life (Years) | Aggregate Intrinsic Value (in millions) |
|---|----------|---|---|---|
| Outstanding, December 31, 2018 | 573,242 | \$ 57.78 | 6.6 | \$ 6 |
| Granted | 252,200 | 66.52 | | |
| Exercised | (21,322) | 36.14 | | |
| Canceled | (5,366) | 68.94 | | |
| Forfeited or expired | (4,699) | 70.98 | | |
| Outstanding, December 31, 2019 | 794,055 | \$ 60.98 | 6.5 | \$ 7 |
| Exercisable, December 31, 2019 | 341,322 | \$ 50.50 | 4.3 | \$ 7 |
| Vested or expected to vest, December 31, 2019 | 793,684 | \$ 60.98 | 6.5 | \$ 7 |

| (in millions) | 2019 | 2018 | 2017 |
|---|------|------|------|
| Intrinsic value of option exercises | \$ 1 | \$ 1 | \$ 6 |
| Cash received from stock option exercises | 1 | 1 | 3 |
| Tax benefit related to stock option exercises | — | — | 2 |
| Fair value of options vested | 3 | 2 | 3 |

Stock Awards

Restricted Stock Units (RSUs) are awarded to eligible employees and entitle the grantee to receive shares of common stock at the end of the vesting period. The fair value of the RSUs is based on the stock price on the date of grant. Generally, RSUs “cliff vest” after three years, or the period from the date of grant to the employee’s retirement eligibility, and expense is recognized accordingly. Performance Share Units (PSUs) are awarded to certain executives to receive shares of common stock if specific performance goals and market conditions are achieved. There are several tranches of PSUs which vest when performance goals and market conditions are met.

The following table summarizes information about outstanding stock awards:

| | Number of Units | Weighted-Average Grant Date Fair Value | Weighted-Average Contractual Life (Years) | Aggregate Intrinsic Value (in millions) |
|-------------------------------|-----------------|--|---|---|
| Non-vested, December 31, 2018 | 511,813 | \$ 78.75 | 1.5 | \$ 31 |
| Granted | 402,816 | 66.35 | | |
| Vested | (270,802) | 74.61 | | |
| Forfeited | (102,214) | 75.21 | | |
| Non-vested, December 31, 2019 | 541,613 | \$ 71.82 | 1.4 | \$ 37 |

Deferred Stock Awards

Deferred Stock Units (DSUs) are awarded to members of the Board of Directors as part of their retainers. The underlying common shares are issued upon retirement from the Board, but require no future service period. As a result, the entire intrinsic value of the awards is expensed on the date of grant.

Employee Stock Purchase Plan

The ESPP allows employees to purchase common stock at 85% of the stock price on the first day of the offering period or the specified purchase date, whichever is lower. Employees may contribute up to 10% of their base earnings during the offering period to purchase stock. Employees purchased 784,786, 632,145 and 406,628 shares in 2019, 2018 and 2017 under the ESPP.

NOTE 13. OPERATING SEGMENT INFORMATION

Alaska Air Group has two operating airlines—Alaska and Horizon. Each is a regulated airline by the U.S. Department of Transportation’s Federal Aviation Administration. Alaska has CPAs for regional capacity with Horizon, as well as with third-party carriers SkyWest and PenAir, under which Alaska receives all passenger revenues.

Under U.S. General Accepted Accounting Principles, operating segments are defined as components of a business for which there is discrete financial information that is regularly assessed by the Chief Operating Decision Maker (CODM) in making resource allocation decisions. Financial performance for the operating airlines and CPAs is managed and reviewed by the Company’s CODM as part of three reportable operating segments:

- **Mainline** - includes scheduled air transportation on Alaska’s Boeing or Airbus jet aircraft for passengers and cargo throughout the U.S., and in parts of Canada, Mexico, and Costa Rica.
- **Regional** - includes Horizon’s and other third-party carriers’ scheduled air transportation for passengers across a shorter distance network within the U.S. under CPAs. This segment includes the actual revenues and expenses associated with regional flying, as well as an allocation of corporate overhead incurred by Air Group on behalf of the regional operations.
- **Horizon** - includes the capacity sold to Alaska under CPA. Expenses include those typically borne by regional airlines such as crew costs, ownership costs and maintenance costs.

The CODM makes resource allocation decisions for these reporting segments based on flight profitability data, aircraft type, route economics and other financial information.

The "Consolidating and Other" column reflects parent company activity, McGee Air Services, consolidating entries and other immaterial business units of the company. The "Air Group Adjusted" column represents a non-GAAP measure that is used by the Company CODM to evaluate performance and allocate resources. Adjustments are further explained below in reconciling to consolidated GAAP results.

Operating segment information is as follows (in millions):

| | Year Ended December 31, 2019 | | | | | | |
|---|------------------------------|--------------|--------------|--------------------------------------|-----------------------------------|------------------------------|-----------------|
| | Mainline | Regional | Horizon | Consolidating & Other ^(a) | Air Group Adjusted ^(b) | Special Items ^(c) | Consolidated |
| Operating Revenues | | | | | | | |
| Passenger revenues | 6,750 | 1,345 | — | — | 8,095 | — | 8,095 |
| CPA revenues | — | — | 450 | (450) | — | — | — |
| Mileage Plan other revenue | 419 | 46 | — | — | 465 | — | 465 |
| Cargo and other | 212 | 3 | 1 | 5 | 221 | — | 221 |
| Total Operating Revenues | 7,381 | 1,394 | 451 | (445) | 8,781 | — | 8,781 |
| Operating Expenses | | | | | | | |
| Non-fuel operating expenses | 4,778 | 1,097 | 385 | (464) | 5,796 | 44 | 5,840 |
| Fuel expense | 1,589 | 295 | — | — | 1,884 | (6) | 1,878 |
| Total Operating Expenses | 6,367 | 1,392 | 385 | (464) | 7,680 | 38 | 7,718 |
| Non-operating Income (Expense) | | | | | | | |
| Interest income | 66 | — | — | (24) | 42 | — | 42 |
| Interest expense | (76) | — | (28) | 26 | (78) | — | (78) |
| Interest capitalized | 15 | — | — | — | 15 | — | 15 |
| Other | (26) | — | — | — | (26) | — | (26) |
| Total Non-operating Income (Expense) | (21) | — | (28) | 2 | (47) | — | (47) |
| Income (Loss) Before Income Tax | \$ 993 | \$ 2 | \$ 38 | \$ 21 | \$ 1,054 | \$ (38) | \$ 1,016 |

| | Year Ended December 31, 2018 | | | | | | |
|---|------------------------------|-----------------|--------------|--------------------------------------|-----------------------------------|------------------------------|---------------|
| | Mainline | Regional | Horizon | Consolidating & Other ^(a) | Air Group Adjusted ^(b) | Special Items ^(c) | Consolidated |
| Operating Revenues | | | | | | | |
| Passenger revenues | 6,474 | 1,157 | — | — | 7,631 | — | 7,631 |
| CPA revenues | — | — | 508 | (508) | — | — | — |
| Mileage Plan other revenue | 397 | 37 | — | — | 434 | — | 434 |
| Cargo and other | 192 | 3 | 4 | — | 199 | — | 199 |
| Total Operating Revenues | 7,063 | 1,197 | 512 | (508) | 8,264 | — | 8,264 |
| Operating Expenses | | | | | | | |
| Non-fuel operating expenses | 4,577 | 1,024 | 465 | (513) | 5,553 | 132 | 5,685 |
| Fuel expense | 1,652 | 262 | — | — | 1,914 | 22 | 1,936 |
| Total Operating Expenses | 6,229 | 1,286 | 465 | (513) | 7,467 | 154 | 7,621 |
| Non-operating Income (Expense) | | | | | | | |
| Interest income | 53 | — | — | (15) | 38 | — | 38 |
| Interest expense | (82) | — | (22) | 13 | (91) | — | (91) |
| Interest capitalized | 16 | — | 2 | — | 18 | — | 18 |
| Other | (12) | (11) | — | — | (23) | — | (23) |
| Total Non-operating Income (Expense) | (25) | (11) | (20) | (2) | (58) | — | (58) |
| Income (Loss) Before Income Tax | \$ 809 | \$ (100) | \$ 27 | \$ 3 | \$ 739 | \$ (154) | \$ 585 |

| Year Ended December 31, 2017 | | | | | | | |
|---|-----------------|--------------|---------------|--------------------------------------|-----------------------------------|------------------------------|-----------------|
| | Mainline | Regional | Horizon | Consolidating & Other ^(a) | Air Group Adjusted ^(b) | Special Items ^(c) | Consolidated |
| Operating Revenues | | | | | | | |
| Passenger revenues | 6,278 | 1,023 | — | — | 7,301 | — | 7,301 |
| CPA revenues | — | — | 426 | (426) | — | — | — |
| Mileage Plan other revenue | 387 | 31 | — | — | 418 | — | 418 |
| Cargo and other | 167 | 4 | 4 | — | 175 | — | 175 |
| Total Operating Revenues | 6,832 | 1,058 | 430 | (426) | 7,894 | — | 7,894 |
| Operating Expenses | | | | | | | |
| Non-fuel operating expenses | 4,271 | 852 | 427 | (427) | 5,123 | 116 | 5,239 |
| Fuel expense | 1,282 | 172 | — | — | 1,454 | (7) | 1,447 |
| Total Operating Expenses | 5,553 | 1,024 | 427 | (427) | 6,577 | 109 | 6,686 |
| Non-operating Income (Expense) | | | | | | | |
| Interest income | 39 | — | — | (5) | 34 | — | 34 |
| Interest expense | (92) | — | (13) | 2 | (103) | — | (103) |
| Interest capitalized | 15 | — | 2 | — | 17 | — | 17 |
| Other | 3 | — | — | — | 3 | — | 3 |
| Total Non-operating Income (Expense) | (35) | — | (11) | (3) | (49) | — | (49) |
| Income (Loss) Before Income Tax | \$ 1,244 | \$ 34 | \$ (8) | \$ (2) | \$ 1,268 | \$ (109) | \$ 1,159 |

(a) Includes consolidating entries, Parent Company, McGee Air Services, and other immaterial business units.

(b) The Air Group Adjusted column represents the financial information that is reviewed by management to assess performance of operations and determine capital allocations and excludes certain income and charges.

(c) Includes merger-related costs, mark-to-market fuel-hedge accounting adjustments, and other special items.

| | 2019 | 2018 | 2017 |
|---------------------------------------|------------------|------------------|-----------------|
| Depreciation and amortization: | | | |
| Mainline | \$ 337 | \$ 316 | \$ 308 |
| Horizon | 86 | 82 | 64 |
| Consolidated | \$ 423 | \$ 398 | \$ 372 |
| Capital expenditures: | | | |
| Mainline | \$ 605 | \$ 571 | \$ 734 |
| Horizon | 91 | 389 | 292 |
| Consolidated | \$ 696 | \$ 960 | \$ 1,026 |
| Total assets at end of period: | | | |
| Mainline | \$ 19,207 | \$ 16,853 | |
| Horizon | 1,266 | 1,229 | |
| Consolidating & Other | (7,480) | (7,170) | |
| Consolidated | \$ 12,993 | \$ 10,912 | |

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Principal Executive Officer and Principal Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based on that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting during the quarter ended December 31, 2019.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the 2013 framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Framework). Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2019.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis, improve these controls and procedures over time, and correct any deficiencies that we may discover in the future. While we believe the present design of our disclosure controls and procedures and internal control over financial reporting are effective, future events affecting our business may cause us to modify our controls and procedures.

The Company's independent registered public accounting firm has issued an attestation report regarding its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2019.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Alaska Air Group, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Alaska Air Group, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively, the consolidated financial statements), and our report dated February 12, 2020 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

Seattle, Washington
February 12, 2020

ITEM 9B. OTHER INFORMATION

As previously reported in a Form 8-K filed by Alaska Air Group, Inc. (the “Company”) on January 6, 2020, Brandon S. Pedersen will resign as the Company’s Executive Vice President Finance, Chief Financial Officer and Treasurer, effective March 2, 2020. On February 11, 2020, the Compensation Committee of the Company’s Board of Directors (the “Committee”) approved the terms of an agreement to be entered into by the Company and Mr. Pedersen (the “Retirement & Release Agreement”). Under the Retirement & Release Agreement, Mr. Pedersen will receive a pro-rated amount of the award he would have received for 2020 under the Company’s Performance Based Pay Plan had he remained employed through the end of the year, and he will be deemed to have met the requirements to receive benefits under the Company’s Travel Benefits for Former Officers policy. In addition, his resignation will be treated as a “retirement” for purposes of his outstanding equity awards granted by the Company, such that his awards of stock units that are subject to performance-based vesting will remain outstanding until the end of the applicable performance period and vest on a pro-rated basis based on the Company’s performance against the goals established for that period and the period of his employment with the Company during each period, and his awards of stock units that are subject only to time-based vesting will vest in full upon his resignation. Any portion of Mr. Pedersen’s outstanding and unvested stock options that are scheduled to vest within three years after his retirement date will be fully vested on that date, and his vested options will remain exercisable for three years following his retirement (provided, however, that any options that vest upon his resignation may not be exercised prior to their original vesting date and that all of his vested options will remain subject to earlier termination at the end of the maximum term of the option or in connection with a change in control of the Company). The Retirement Agreement will also include a non-competition commitment for a period of 24 months following his separation and other covenants favorable to the Company.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

See “Executive Officers” under Item 1, “Our Business,” in Part I of this Form 10-K for information on the executive officers of Air Group and its subsidiaries. Except as provided herein, the remainder of the information required by this item is incorporated herein by reference from the definitive Proxy Statement for Air Group’s 2020 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year ended December 31, 2019 (hereinafter referred to as our “2020 Proxy Statement”).

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference from our 2020 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT, AND RELATED STOCKHOLDER MATTERS

Securities Authorized for Issuance Under Equity Compensation Plans

| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 1,698,035 ⁽¹⁾ | \$60.98 ⁽²⁾ | 8,627,341 ⁽³⁾ |
| Equity compensation plans not approved by security holders | — | Not applicable | — |
| Total | 1,698,035 | \$60.98 | 8,627,341 |

- (1) Of these shares, 269,958 and 524,097 were subject to options then outstanding under the 2008 Plan and 2016 Plan, 83,246 were subject to outstanding restricted, performance and deferred stock unit awards granted under the 2008 Plan and 820,734 were subject to outstanding restricted, performance and deferred stock unit awards granted under the 2016 Plan. Outstanding performance awards are reflected in the table assuming that the target level of performance will be achieved.
- (2) This number does not reflect the 903,980 shares that were subject to outstanding stock unit awards granted under the 2008 and 2016 Plans.
- (3) Of the aggregate number of shares that remained available for future issuance, no shares were available under the 2008 Plan, 4,245,573 shares were available under the 2016 Plan and 4,381,768 shares were available under the ESPP. Subject to certain express limits of the 2016 Plan, shares available for award purposes under the 2016 Plan generally may be used for any type of award authorized under that plan including options, stock appreciation rights, and other forms of awards granted or denominated in shares of our common stock including, without limitation, stock bonuses, restricted stock, restricted stock units and performance shares. Full-value shares issued under the 2016 Plan are counted against the share limit as 1.7 shares for every one share issued. This table does not give effect to that rule.

Other information required by this item is set forth under the heading “Beneficial Ownership of Securities” in our 2020 Proxy Statement and is incorporated by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated herein by reference from our 2020 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference from our 2020 Proxy Statement.

PART IV

ITEM 15. EXHIBITS

The following documents are filed as part of this report:

1. *Exhibits:* See Exhibit Index.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ALASKA AIR GROUP, INC.

By: /s/ BRADLEY D. TILDEN

Date: February 12, 2020

Bradley D. Tilden

Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on February 12, 2020 on behalf of the registrant and in the capacities indicated.

| | |
|--|---|
| <u>/s/ BRADLEY D. TILDEN</u> Bradley D. Tilden | Chairman and Chief Executive Officer (Principal Executive Officer) |
| <u>/s/ BRANDON S. PEDERSEN</u> Brandon S. Pedersen | Executive Vice President/Finance and Chief Financial Officer (Principal Financial Officer) |
| <u>/s/ CHRISTOPHER M. BERRY</u> Christopher M. Berry | Vice President Finance and Controller (Principal Accounting Officer) |
| <u>/s/ PATRICIA M. BEDIENT</u> Patricia M. Bedient | Director |
| <u>/s/ JAMES A. BEER</u> James A. Beer | Director |
| <u>/s/ MARION C. BLAKEY</u> Marion C. Blakey | Director |
| <u>/s/ PHYLLIS J. CAMPBELL</u> Phyllis J. Campbell | Director |
| <u>/s/ RAYMOND L. CONNER</u> Raymond L. Conner | Director |
| <u>/s/ DHIREN R. FONSECA</u> Dhiren R. Fonseca | Director |
| <u>/s/ KATHLEEN T. HOGAN</u> Kathleen T. Hogan | Director |
| <u>/s/ SUSAN J. LI</u> Susan J. Li | Director |
| <u>/s/ HELVI K. SANDVIK</u> Helvi K. Sandvik | Director |
| <u>/s/ J. KENNETH THOMPSON</u> J. Kenneth Thompson | Director |
| <u>/s/ ERIC K. YEAMAN</u> Eric K. Yeaman | Director |

EXHIBIT INDEX

Certain of the following exhibits have been filed with the Securities and Exchange Commission and are incorporated by reference from the documents below. Certain others are filed with this Form 10-K. The exhibits are numbered in accordance with Item 601 of Regulation S-K.

| Exhibit Number | Exhibit Description | Form | Date of First Filing | Exhibit Number | File Number |
|----------------|---|--------|----------------------|----------------|-------------|
| 3.1 | Amended and Restated Certificate of Incorporation of Registrant | 10-Q | August 3, 2017 | 3.1 | |
| 10.1# | Aircraft General Terms Agreement, dated June 15, 2005, between the Boeing Company and Alaska Airlines, Inc. | 10-Q | August 5, 2005 | 10.1 | |
| 10.2# | Purchase Agreement No. 2497, dated June 15, 2005, between the Boeing Company and Alaska Airlines, Inc. | 10-Q | August 5, 2005 | 10.2 | |
| 10.3# | Supplemental Agreement No. 23 to Purchase Agreement No. 2497 between The Boeing Company and Alaska Airlines, Inc. | 10-Q/A | August 2, 2011 | 10.1 | |
| 10.4# | Supplemental Agreement No. 29 to Purchase Agreement No. 2497 between The Boeing Company and Alaska Airlines, Inc. | 10-K | February 14, 2013 | 10.1 | |
| 10.5# | Purchase Agreement No. 3866 between The Boeing Company and Alaska Airlines, Inc. | 10-K | February 14, 2013 | 10.2 | |
| 10.6# | Supplemental Agreement No. 39 to Purchase Agreement No. 2497 between The Boeing Company and Alaska Airlines, Inc. | 10-Q | May 7, 2015 | 10.1 | |
| 10.7# | Purchase Agreement, dated April 11, 2016, between Embraer S.A. and Horizon Air Industries, Inc. | 10-Q | May 9, 2016 | 10.1 | |
| 10.8^ | A320 Aircraft Purchase Agreement, dated as of December 29, 2010, between Airbus S.A.S. and Virgin America Inc. | S-1/A^ | October 7, 2014 | 10.15 | |
| 10.9* | Alaska Air Group, Inc. 2008 Performance Incentive Plan, Form of Nonqualified Stock Option Agreement | 10-Q | August 4, 2011 | 10.3 | |
| 10.10* | Alaska Air Group, Inc. 2008 Performance Incentive Plan, Form of Performance Stock Unit Award Agreement | 10-Q | August 4, 2011 | 10.4 | |
| 10.11* | Alaska Air Group, Inc. 2008 Performance Incentive Plan, Amended for Stock-Split | 10-K | February 11, 2016 | 10.10 | |
| 10.12* | Alaska Air Group, Inc. 2016 Performance Incentive Plan | 8-K | May 18, 2016 | 10.1 | |
| 10.13* | Alaska Air Group, Inc. 2016 Performance Incentive Plan, Form of Nonqualified Stock Option Agreement | 10-Q | August 2, 2016 | 10.1 | |
| 10.14* | Alaska Air Group, Inc. 2016 Performance Incentive Plan, Form of Incentive Stock Option Agreement | 10-Q | August 2, 2016 | 10.2 | |
| 10.15* | Alaska Air Group, Inc. 2016 Performance Incentive Plan, Form of Performance Stock Unit Award Agreement | 10-Q | August 2, 2016 | 10.3 | |
| 10.16* | Alaska Air Group, Inc. 2016 Performance Incentive Plan, Form of Stock Unit Award Agreement | 10-Q | August 2, 2016 | 10.4 | |
| 10.17* | Alaska Air Group, Inc. 2010 Employee Stock Purchase Plan, as Amended for the Offering Period Commencing March 1, 2017 | 10-K | February 28, 2017 | 10.18 | |
| 10.18* | Alaska Air Group, Inc. Stock Deferral Plan for Non-Employee Directors | 10-K | February 11, 2016 | 10.12 | |
| 10.19* | Alaska Air Group, Inc. Nonqualified Deferred Compensation Plan, as amended | 10-Q | August 4, 2011 | 10.1 | |
| 10.20* | 1995 Elected Officers Supplementary Retirement Plan, as amended | 10-Q | August 4, 2011 | 10.2 | |
| 10.21* | Form of Alaska Air Group, Inc. Change of Control Agreement for named executive officers, as amended and restated October 16, 2014 | 10-K | February 11, 2016 | 10.15 | |
| 10.22* | Alaska Air Group Performance Based Pay Plan, Amended and Restated January 16, 2019 | 10-K | February 14, 2019 | 10.26 | |
| 10.23*† | Alaska Air Group Operational Performance Rewards Plan Description, adopted January 3, 2005; Amended November 7, 2019 | | | | |
| 10.24*† | Alaska Air Group, Inc. Non-Employee Director Form of Deferred Stock Unit Agreement | | | | |
| 21† | Subsidiaries of Registrant | | | | |
| 23.1† | Consent of Independent Registered Public Accounting Firm (KPMG LLP) | | | | |
| 31.1† | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | |
| 31.2† | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | |

| | |
|----------|--|
| 32.1† | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2† | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS† | XBRL Instance Document - The instance document does not appear in the interactive data file because XBRL tags are embedded within the inline XBRL document. |
| 101.SCH† | XBRL Taxonomy Extension Schema Document |
| 101.CAL† | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF† | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB† | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE† | XBRL Taxonomy Extension Presentation Linkbase Document |
| † | Filed herewith |
| * | Indicates management contract or compensatory plan or arrangement. |
| # | Pursuant to 17 CFR 240.24b-2, confidential information has been omitted and filed separately with the Securities and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission. |
| ^ | Filed by Virgin America Inc., File Number 333-197660 |

ALASKA AIR GROUP
OPERATIONAL PERFORMANCE REWARDS PLAN

Adopted January 3, 2005; Amended November 7, 2019 (Effective December 1, 2019)

The Board of Directors of Alaska Air Group, Inc. (the "Company") has adopted the Operational Performance Rewards Plan (the "Plan") to reward employees of Alaska Airlines, Inc. ("Alaska") and Horizon Air Industries, Inc. ("Horizon") (each a "Subsidiary") for achieving certain operational performance targets. This description is provided to explain the key elements of how the Plan will operate. This Plan is effective beginning with the 2019 Plan year and each year thereafter until amended or terminated as provided herein.

1. ELIGIBILITY

All regular employees and temporary variable-time employees of Alaska and Horizon (including employees outside of the United States, if permitted by applicable law and labor contracts) are eligible to participate in the Plan ("Eligible Employees"), and will receive one or more payments under the Plan if they meet the criteria in this paragraph. Payments under the Plan ("Awards") are earned monthly and paid quarterly. Eligible Employees on active status or on an approved leave of absence as of the close of business on the last day of the quarter during which (a) any of the monthly operational targets applicable to such employee's applicable Subsidiary are met and (b) employee had eligible earnings as defined in the Company's Performance Based Pay Plan during the quarter will be eligible for a payout for each month of the quarter in which the employee's applicable Subsidiary's operational targets are met. For persons with Voluntary Severance Incentive or equivalent severance packages (whether voluntary or not), the last day of eligible employment will not include any of the period during which the employee has ceased working but is still otherwise treated as on payroll.

Unless otherwise provided in a separate agreement, an individual whose employment with Alaska and Horizon ends prior to the last day of the quarter for any reason not set forth above, for example, resignation or termination (with or without cause), forfeits any Award under this Plan. In addition, employees terminated for cause, as determined by such employee's applicable subsidiary, shall forfeit any Award under this Plan, regardless of their employment status on the last day of the quarter. Notwithstanding the foregoing, contract employees or independent contractors as classified by Alaska or Horizon, as applicable, shall be excluded from participation hereunder, regardless of whether an agency or court subsequently reclassifies such individuals as employees of Alaska or Horizon. An Eligible Employee who meets all the requirements for an Award is a "Plan Participant." Participation in the Plan does not guarantee that any Award will be paid if applicable operational targets are not achieved.

2. ACCRUAL OF AWARDS

An Award will accrue for each Participant as of the close of business of the last day of any quarter in which the applicable Subsidiary has achieved one or more of the performance goals set forth in Exhibit A. Each Subsidiary does not need to achieve all of the performance goals in a given quarter to accrue an Award; each goal reached in a given Target Period (as defined in Exhibit A) will apply separately towards the Award to that Subsidiary's Participants for that quarter.

3. PAYMENT OF AWARDS

Accrued Awards will be paid quarterly. The Company will use reasonable efforts to pay accrued Awards to Participants within sixty (60) days after the end of each calendar quarter. The Company may pay Awards through regular payroll or by separate check in the Company's discretion, and in either case the Company may withhold applicable taxes and garnishments from such payments. The Company will pay a deceased Participant's Award to the beneficiary designated by the Participant for purposes of the Company's group term life insurance plan covering the deceased Participant, and in the absence of any designation, will be paid to the Participant's estate.

4. ESTABLISHMENT OF PERFORMANCE GOALS

The Compensation and Leadership Development Committee of the Board (the "Compensation Committee") will establish the periodic performance goals for each Plan year during the life of this Plan, and will provide an exhibit to this Plan that outlines goals and the payout amounts for each goal. Each such attachment will be labeled "Exhibit A: Operational Performance Rewards Plan Goals and Award Levels for [year]" and communicated to eligible employees.

5. AMENDMENT; TERMINATION; INTERPETATION

The Board, acting through the Compensation Committee, retains the right at any time to modify the Plan in any manner that it deems appropriate or to terminate the Plan, provided that no amendment or termination shall be effective sooner than the first day of the month following the Compensation Committee's action on such amendment or termination. No termination of the Plan shall affect Awards accrued before the effective date of termination. Management may interpret or amend this Plan Description with respect to administrative issues that do not affect benefit amounts and are not otherwise material to the overall benefits provided by the Plan. The Compensation Committee shall have discretion to interpret and resolve any material issue or dispute under the Plan, and its decision concerning any aspect of the operation of the Plan will be final and conclusive. The Compensation Committee will review the Plan annually and may make changes to the Plan and/or Exhibit A for the next Plan year.

6. CLAWBACK POLICY

Awards are subject to the terms of the Company's recoupment, clawback or similar policy as it may be in effect from time to time, as well as any similar provisions of applicable law, any of which could in certain circumstances require forfeiture of the Awards and repayment or forfeiture of any cash received with respect to the Awards.

7. MISCELLANEOUS

This description, including its attachments, constitutes the entire understanding relating to the Plan, and supersedes all prior oral or written agreements, representations or commitments relating to the Plan or any Award. This Plan is not a commitment of the Company, Alaska or Horizon, to any officer or employee of any such company to continue that individual in its employ for any reason. Any employee who files suit against his or her employer for wrongful termination shall automatically cease to be a Participant. This description and the rights and obligations provided for herein shall be construed and interpreted in accordance with the law of the state of Washington, excluding its conflicts of law rules.

ALASKA AIR GROUP, INC.
2016 PERFORMANCE INCENTIVE PLAN
DIRECTOR DEFERRED STOCK UNIT AWARD AGREEMENT

THIS DIRECTOR DEFERRED STOCK UNIT AWARD AGREEMENT (this “**Agreement**”) dated _____, by and between **ALASKA AIR GROUP, INC.**, a Delaware corporation (the “**Corporation**”), and _____ (the “**Director**”) evidences the award of stock units (the “**Award**”) granted by the Corporation to the Director as to the number of stock units (the “**Stock Units**”) first set forth below.

| | |
|--------------------------------------|-------------|
| Number of Stock Units ¹ : | Award Date: |
|--------------------------------------|-------------|

Vesting The Stock Units shall be considered one hundred percent (100%) vested at all times.

The Award is granted under the Alaska Air Group, Inc. 2016 Performance Incentive Plan (the “**Plan**”) and subject to the Terms and Conditions of Director Deferred Stock Unit Award (the “**Terms**”) attached to this Agreement (incorporated herein by this reference) and to the Plan. The Award has been granted to the Director in addition to, and not in lieu of, any other form of compensation otherwise payable or to be paid to the Director. Capitalized terms are defined in the Plan if not defined herein. The parties agree to the terms of the Award set forth herein. The Director acknowledges receipt of a copy of the Terms, the Plan and the Prospectus for the Plan.

| | |
|-----------------------|---|
| DIRECTOR _____ | ALASKA AIR GROUP, INC. a Delaware corporation By: _____ Bradley D. Tilden Chairman, President and CEO |
|-----------------------|---|

¹ Subject to adjustment under Section 7.1 of the Plan.

TERMS AND CONDITIONS OF DIRECTOR DEFERRED STOCK UNIT AWARD

1. **Stock Units.** As used herein, the term “stock unit” shall mean a non-voting unit of measurement which is deemed for bookkeeping purposes to be equivalent to one outstanding share of the Corporation’s Common Stock (subject to adjustment as provided in Section 7.1 of the Plan) solely for purposes of the Plan and this Agreement. The Stock Units shall be used solely as a device for the determination of the payment to eventually be made to the Director pursuant to this Agreement. The Stock Units shall not be treated as property or as a trust fund of any kind.

2. **No Service Commitment.** Neither the Award nor anything contained in these Terms or the Plan constitutes a continued service commitment by the Corporation or interferes with the right of the Corporation to increase or decrease the compensation of the Director from the rate in existence at any time.

3. **Limitations on Rights Associated with Units.** The Director shall have no rights as a stockholder of the Corporation, no dividend rights and no voting rights, with respect to the Stock Units and any shares of Common Stock underlying or issuable in respect of such Stock Units until such shares of Common Stock are actually issued to and held of record by the Director. No adjustments will be made for dividends or other rights of a holder for which the record date is prior to the date of issuance of the stock certificate.

4. **Restrictions on Transfer.** Neither the Award, nor any interest therein or amount or shares payable in respect thereof may be sold, assigned, transferred, pledged or otherwise disposed of, alienated or encumbered, either voluntarily or involuntarily. The transfer restrictions in the preceding sentence shall not apply to (a) transfers to the Corporation, or (b) transfers by will or the laws of descent and distribution.

5. **Timing and Manner of Payment of Stock Units.** On or as soon as administratively practical after (and in all events not more than ninety (90) days after) the first date on which the Director is no longer a member of the Board (the “**Severance Date**”), the Corporation shall deliver to the Director a number of shares of Common Stock (either by delivering one or more certificates for such shares or by entering such shares in book entry form, as determined by the Corporation in its discretion) equal to the number of Stock Units subject to this Award; provided, however, that in all events the Director’s Severance Date will be the date on which the Director incurs a “separation from service” within the meaning of Treasury Regulation Section 1.409A-1(h)(1), without regard to the optional alternative definitions available thereunder (i.e. generally the date on which the Director is no longer a member of the Board or employed by the Corporation or a Subsidiary); and provided, further, that in the event the Director is a “specified employee” (within the meaning of Treasury Regulation Section 1.409A-1(i)) on the Severance Date, the Director shall not be entitled to any payment of the Stock Units until the earlier of (i) the date which is six (6) months after his separation from service with the Corporation for any reason other than death, or (ii) the date of the Director’s death, if and to the extent such delay in payment is required to comply with Section 409A of the Code. The Corporation’s obligation to deliver shares of Common Stock or otherwise make payment with respect to the Stock Units is subject to the condition precedent that the Director or other person entitled under the Plan to receive any shares with respect to the Stock Units deliver to the Corporation any representations or other documents or assurances that the Administrator may deem necessary or desirable to assure compliance with all applicable legal and accounting requirements.

6. Adjustments Upon Specified Events. Upon the occurrence of certain events relating to the Corporation's stock contemplated by Section 7.1 of the Plan (including, without limitation, an extraordinary cash dividend on such stock), the Administrator shall make adjustments in accordance with such section in the number of Stock Units then outstanding and the number and kind of securities that may be issued in respect of the Award. No such adjustment shall be made with respect to any ordinary cash dividend paid on the Common Stock.

7. Tax Withholding. Subject to Section 8.1 of the Plan, upon any distribution of shares of Common Stock in respect of the Stock Units, the Corporation shall automatically reduce the number of shares to be delivered by (or otherwise reacquire) the appropriate number of whole shares, valued at their then fair market value (determined in accordance with the applicable provisions of the Plan), to satisfy any withholding obligations of the Corporation or its Subsidiaries with respect to such distribution of shares at the minimum applicable withholding rates. In the event that the Corporation cannot legally satisfy such withholding obligations by such reduction of shares, or in the event of a cash payment or any other withholding event in respect of the Stock Units, the Corporation (or a Subsidiary) shall be entitled to require a cash payment by or on behalf of the Director and/or to deduct from other compensation payable to the Director any sums required by federal, state or local tax law to be withheld with respect to such distribution or payment.

8. Notices. Any notice to be given under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal office to the attention of the Secretary, and to the Director at the Director's last address reflected on the Corporation's records, or at such other address as either party may hereafter designate in writing to the other. Any such notice shall be given only when received, but if the Director is no longer a member of the Board, shall be deemed to have been duly given by the Corporation when enclosed in a properly sealed envelope addressed as aforesaid, registered or certified, and deposited (postage and registry or certification fee prepaid) in a post office or branch post office regularly maintained by the United States Government.

9. Plan. The Award and all rights of the Director under this Agreement are subject to the terms and conditions of the provisions of the Plan, incorporated herein by reference. The Director agrees to be bound by the terms of the Plan and this Agreement. The Director acknowledges having read and understanding the Plan, the Prospectus for the Plan, and this Agreement. Unless otherwise expressly provided in other sections of this Agreement, provisions of the Plan that confer discretionary authority on the Board or the Administrator do not (and shall not be deemed to) create any rights in the Director unless such rights are expressly set forth herein or are otherwise in the sole discretion of the Board or the Administrator so conferred by appropriate action of the Board or the Administrator under the Plan after the date hereof.

10. Entire Agreement. This Agreement and the Plan together constitute the entire agreement and supersede all prior understandings and agreements, written or oral, of the parties hereto with respect to the subject matter hereof. The Plan and this Agreement may be amended pursuant to Section 8.6 of the Plan. Such amendment must be in writing and signed by the Corporation. The Corporation may, however, unilaterally waive any provision hereof in writing to the extent such waiver does not adversely affect the interests of the Director hereunder, but no such waiver shall operate as or be construed to be a subsequent waiver of the same provision or a waiver of any other provision hereof.

11. Limitation on Director's Rights. Participation in the Plan confers no rights or interests other than as herein provided. This Agreement creates only a contractual obligation on the part of the Corporation as to amounts payable and shall not be construed as creating a trust. Neither the Plan nor any

underlying program, in and of itself, has any assets. The Director shall have only the rights of a general unsecured creditor of the Corporation with respect to amounts credited and benefits payable, if any, with respect to the Stock Units, and rights no greater than the right to receive the Common Stock as a general unsecured creditor with respect to Stock Units, as and when payable hereunder.

12. Counterparts. This Agreement may be executed simultaneously in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

13. Section Headings. The section headings of this Agreement are for convenience of reference only and shall not be deemed to alter or affect any provision hereof.

14. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to conflict of law principles thereunder.

15. Construction. It is intended that the terms of the Award will not result in the imposition of any tax liability pursuant to Section 409A of the Code. This Agreement shall be construed and interpreted consistent with that intent.

EXHIBIT 21

SUBSIDIARIES OF ALASKA AIR GROUP, INC.

| Name | State of Incorporation |
|---|-------------------------------|
| Alaska Airlines, Inc. | Alaska |
| Horizon Air Industries, Inc. | Washington |
| McGee Air Services, Inc. ^(a) | Delaware |
| ASA Assurance, Inc. | Hawaii |
| AAG Leasing, Inc. | Delaware |
| ASA Beverages, LLC. ^(a) | Delaware |
| AAG Real Property, LLC. ^(a) | Delaware |

(a) McGee Air Services, Inc., ASA Beverages, LLC. and AAG Real Property, LLC. are subsidiaries of Alaska Airlines, Inc.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors

Alaska Air Group, Inc.:

We consent to the incorporation by reference in the registration statements (No. 333-212657, 333-176051, 333-168293, and 333-151743) on Form S-8 of Alaska Air Group, Inc. of our reports dated February 12, 2020, with respect to the consolidated balance sheets of Alaska Air Group, Inc. and subsidiaries as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively, the "consolidated financial statements"), and the effectiveness of internal control over financial reporting as of December 31, 2019, which reports appear in the December 31, 2019 annual report on Form 10-K of Alaska Air Group, Inc.

Our report on the consolidated financial statements refers to a change in the method of accounting for leases as of January 1, 2019, upon the adoption of Accounting Standards Codification Topic 842 - *Leases*.

/s/ KPMG LLP

Seattle, Washington
February 12, 2020

EXHIBIT 31.1

CERTIFICATIONS

I, Bradley D. Tilden, certify that:

1. I have reviewed this annual report on Form 10-K of Alaska Air Group, Inc. for the period ended December 31, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- e) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 12, 2020

By: /s/ BRADLEY D. TILDEN

Bradley D. Tilden
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Brandon S. Pedersen, certify that:

1. I have reviewed this annual report on Form 10-K of Alaska Air Group, Inc. for the period ended December 31, 2019;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 12, 2020

By: /s/ BRANDON S. PEDERSEN

Brandon S. Pedersen

Executive Vice President/Finance and Chief Financial Officer

EXHIBIT 32.2

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Alaska Air Group, Inc. (the "Company") on Form 10-K for the period ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Brandon S. Pedersen, Executive Vice President/Finance and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 12, 2020

By: /s/ BRANDON S. PEDERSEN

Brandon S. Pedersen

Executive Vice President/Finance and Chief Financial Officer