ALASKA AIR GROUP INC
Form 10-K
February 19, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from to

Commission File Number 1-8957

ALASKA AIR GROUP, INC.

A Delaware Corporation

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

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

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

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

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

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

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

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

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

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

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

As of January 31, 2009, shares of common stock outstanding totaled 36,294,524. The aggregate market value of the shares of common stock of Alaska Air Group, Inc. held by nonaffiliates on June 30, 2008, was approximately $550.6 million (based on the closing price of $15.34 per share on the New York Stock Exchange on that date).

DOCUMENTS INCORPORATED BY REFERENCE

Title of Document	Part Hereof Into Which Document is to be Incorporated
Definitive Proxy Statement Relating to 2009 Annual Meeting of Shareholders	Part III

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ALASKA AIR GROUP, INC.

ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2008

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

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

general economic conditions, including the impact of the economic recession on customer travel behavior;

changes in our operating costs, including fuel, which can be volatile;

the competitive environment in our industry;

labor disputes and our ability to attract and retain qualified personnel;

the amounts of potential lease termination payments with lessors for our remaining CRJ-700 and Q200 leased aircraft and related sublease payments from sublessees, if applicable;

our significant indebtedness;

compliance with our financial covenants;

potential downgrades of our credit ratings and the availability of financing;

our ability to meet our cost reduction goals;

operational disruptions;

the concentration of our revenue from a few key markets;

actual or threatened terrorist attacks, global instability and potential U.S. military actions or activities;

insurance costs;

- our inability to achieve or maintain profitability;
- fluctuations in our quarterly results;
- an aircraft accident or incident;
- liability and other claims asserted against us;
- our reliance on automated systems and the risks associated with changes made to those systems;
- our reliance on third-party vendors and partners;
- changes in laws and regulations; and
- increases in government fees and taxes.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on which this report was filed with the SEC. We expressly disclaim any obligation to issue any updates or revisions to our forward-looking statements, even if subsequent events cause our expectations to change regarding the matters discussed in those statements. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such differences might be significant and materially adverse to our shareholders. For a discussion of these and other risk factors in this Form 10-K, see Item 1A: Risk Factors. Please consider our forward-looking statements in light of those risks as you read this report.

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PART I

ITEM 1. OUR BUSINESS

We are a Delaware corporation incorporated in 1985 and we have two principal subsidiaries: Alaska Airlines, Inc. (Alaska) and Horizon Air Industries, Inc. (Horizon). Through these subsidiaries, we provide passenger air service to approximately 25 million passengers per year to nearly 100 destinations. We also provide freight and mail services, primarily to and within the state of Alaska and on the West Coast. Although Alaska and Horizon both operate as airlines, their business plans, competition, and economic risks differ substantially. Alaska is a major airline that operates an all-jet fleet with an average passenger trip length in 2008 of 1,113 miles. Horizon is a regional airline, operates turboprop and jet aircraft, and its average passenger trip length for 2008 was 357 miles. Individual financial information about Alaska and Horizon is in Note 13 to the consolidated financial statements and throughout this report, specifically in Management s Discussion and Analysis of Financial Condition and Results of Operations.

Both of our airlines endeavor to distinguish themselves from competitors by providing a higher level of customer service and differentiating amenities. Our outstanding employees and excellent service in the form of advance seat assignments, expedited check-in, web check-in, flight alerts, attention to customer needs, an award-winning frequent flyer program, well-maintained aircraft, a first-class section aboard Alaska aircraft, and other amenities are regularly recognized by independent studies, awards, and surveys of air travelers. For example, Alaska received the J.D. Power and Associates Highest Customer Satisfaction award in 2008 among North America Airlines in a tie with Continental Airlines and won the Program of the Year Freddie award for 2007 for our Mileage Plan program. Additionally, Horizon was named 2007 Regional Airline of the Year by Air Transport World. We are very proud of these awards and we continue to strive to have the best customer service in the industry.

WHERE YOU CAN FIND MORE INFORMATION

We maintain an Internet website at *www.alaskaair.com.* 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 filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available on our website at *www.alaskaair.com,* free of charge, as soon as reasonably practicable after the electronic filing of these reports with the Securities and Exchange Commission. The information contained on our website is not a part of this annual report on Form 10-K.

OUR AIRLINES

ALASKA

Alaska Airlines is an Alaska corporation that was organized in 1932 and incorporated in 1937. We offer extensive north/south service within the western U.S., Canada and Mexico, and passenger and dedicated cargo services to and within the state of Alaska. We also provide long-haul east/west service to Hawaii and nine cities in the continental U.S., primarily from Seattle, where we have our largest concentration of departures; although we do offer long-haul departures from Anchorage, Los Angeles, and Portland, Oregon. During 2008, we initiated service to Maui with non-stops from Seattle and Anchorage, to the Big Island of Hawaii

with non-stops from Seattle, and non-stop service from Seattle to Minneapolis. We also recently announced non-stop service from Seattle to Austin, TX and Portland to Maui, both beginning in August 2009.

In 2008, we carried 16.8 million revenue passengers in our mainline operations, and in each year since 1973, we have carried more passengers between Alaska and the U.S. mainland than any other airline. Based on the

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number of passengers, Alaska s leading airports are Seattle, Los Angeles, Anchorage and Portland. Based on 2008 revenues, the leading nonstop routes are Seattle-Anchorage, Seattle-Los Angeles, and Seattle-San Diego. At December 31, 2008, Alaska s operating fleet consisted of 110 jet aircraft, compared to 115 aircraft as of December 31, 2007.

Alaska s passenger traffic by market is presented below:

	2008	2007
West Coast	41%	46%
Within Alaska and between Alaska and the U.S. mainland	23%	21%
Transcontinental	20%	17%
Mexico	8%	11%
Hawaii	5%	1%
Canada	3%	4%
Total	100%	100%

HORIZON

Horizon Air Industries, a Washington corporation that first began service and was incorporated in 1981, was acquired by Air Group in 1986. It is the largest regional airline in the Pacific Northwest, and serves a number of cities in seven states, five cities in Canada, and two cities in Mexico. Horizon initiated service to Loreto and La Paz, Mexico from Los Angeles in 2008. Additionally, Horizon launched service to Prescott and Flagstaff, Arizona, and Mammoth Lakes, California, in 2008.

In 2008, Horizon carried 7.4 million revenue passengers. Approximately 91% of Horizon s revenue passenger miles in 2008 were flown domestically, primarily in the states of Washington, Oregon, Idaho and California, compared to 92% in 2007. The Canada markets accounted for 8% of revenue passenger miles in both 2008 and 2007. Flying to Mexico in 2008 accounted for less than 1% of total revenue passenger miles. Based on passenger enplanements, Horizon s leading airports are Seattle, Portland, Boise, and Spokane. Based on revenues in 2008, the leading nonstop routes are Portland-Seattle, Spokane-Seattle, and Boise-Seattle. At December 31, 2008, Horizon s operating fleet consisted of 18 jets and 41 turboprop aircraft. Horizon flights are listed under the Alaska Airlines designator code in airline reservation systems.

Alaska and Horizon integrate their flight schedules to provide convenient, competitive connections between most points served by their systems. In 2008 and 2007, approximately 23% and 22%, respectively, of Horizon s passengers connected to flights operated by Alaska.

INDUSTRY CONDITIONS

2008 proved to be an extremely challenging year for the airline industry. We faced record high fuel prices that resulted in liquidation of several airlines and threatened the viability of others. Ancillary fees were added by most carriers to help offset the rising price of

fuel. The last half of the year saw significant declines in the price of oil, but that soon became overshadowed by the economic recession in the U.S. and abroad. As a result, the industry is sharply reducing capacity to help offset the declining demand. Alaska and Horizon plan to reduce capacity in 2009 by 8% and 9%, respectively.

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

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FUEL

Our business and financial results are highly affected by the price and, potentially, the availability of jet fuel. Fuel prices have been extremely volatile over the past few years. The price of crude oil rose from just under $90 per barrel in January 2008 up to nearly $150 per barrel in July 2008. Subsequent to its record high, oil prices began to drop sharply in the last half of 2008 and ended the year around $40 per barrel. For us, a $1 per barrel increase in the price of oil equates to approximately $9 million of additional fuel cost annually.

We refer to the price we pay at the airport or into-plane price, including applicable taxes, as our raw fuel price. Raw fuel prices are impacted by world oil prices and refining costs, which can vary by region in the U.S. Generally, West Coast jet fuel prices are somewhat higher and substantially more volatile than prices in the Gulf Coast or on the East Coast, putting both Alaska and Horizon at a competitive disadvantage. Historically, fuel costs have generally represented 10% to 15% of an airline s operating costs. However, in recent years, because of the rise in prices, fuel expense represents 30% to 40% of total operating costs for airlines. Both the crude oil and refining cost components of jet fuel are volatile and outside of our control, and they can have a significant and immediate impact on our operating results. Even with the sharp decline in prices in the last half of 2008, our average raw fuel cost per gallon increased 42% in 2008 and 8% and 17% in 2007 and 2006, respectively.

We use crude oil call options almost exclusively as hedges to decrease our exposure to the volatility of jet fuel prices. Call options effectively cap our pricing on the crude oil component of fuel prices, limiting our exposure to increasing fuel prices for a percentage of our planned fuel consumption. With these call option contracts, we still benefit from the decline in crude oil prices, as there is no future cash exposure above the premiums we pay to enter into the contracts. We also use collar structures in limited instances for fuel hedging purposes. Additionally, we enter into fuel purchase contracts that fix the refining margin we pay on a certain percentage of our fuel consumption.

Fuel costs, including gains and losses stemming from changes in the value of our hedge portfolio, were approximately 36% of our total operating expenses in 2008, 27% in 2007 and 26% in 2006. For 2009, a one-cent change in our hedged fuel price per gallon affects annual fuel costs by approximately $3.5 million. In addition to our hedging program, we believe that operating fuel-efficient aircraft helps to mitigate the effect of high fuel prices. At Alaska we have completed our fleet transition out of the MD-80 aircraft to more fuel-efficient B737-800 aircraft, and at Horizon we are currently transitioning to an all-Q400 turboprop fleet. Alaska also retrofitted its B737-900 fleet with winglets in 2008. As a result, the fuel burn expressed in available seat miles flown per gallon (ASMs/g) improved over the past two years from 65.9 ASMs/g in 2006 to 69.5 ASMs/g in 2008. This reduction has not only reduced our fuel cost, but

also the amount of greenhouse gases and other pollutants that we emit.

Although we do not anticipate a significant reduction in jet fuel availability because of the decline in global demand, dependency on foreign imports of crude oil and the possibility of changes in government policy on jet fuel production, transportation and marketing make it impossible to predict the future availability of jet fuel. In the event of significant hostilities or other conflicts in oil-producing areas, there could be reductions in the production and/or importation of crude oil resulting in price increases, which could adversely affect our business. If there were major reductions in the availability of jet fuel, our business would be adversely affected.

MARKETING AND COMPETITION

ALLIANCES WITH OTHER AIRLINES

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

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

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

Our marketing alliances with other airlines as of December 31, 2008 are as follows:

	Frequent Flyer Agreement	Codeshare Alaska Flight # on Flights Operated by Other Airline	Codeshare Other Airline Flight # On Flights Operated by Alaska/ Horizon
Major U.S. or International Airlines			
American Airlines/American Eagle	Yes	Yes	Yes

Air France	Yes	No	Yes
British Airways	Yes	No	No
Cathay Pacific Airways	Yes	No	No
Continental Airlines	Yes	Yes	Yes
Delta Air Lines/Delta Connection (2)	Yes	Yes	Yes
KLM	Yes	No	Yes
Korean Air	Yes	No	Yes
Lan S.A.	Yes	No	Yes
Northwest Airlines (4)	Yes	Yes	Yes
Qantas	Yes	No	Yes
Regional Airlines			
Era Aviation	Yes (1)	Yes	No
PenAir	Yes (1)	Yes	No
Mokulele Airlines	Yes (3)	No	No

(1) This airline does not have its own frequent flyer program. However, Alaska s Mileage Plan members can earn and redeem miles on this airline s route system.
(2) Alaska has codeshare agreements with the Delta Connection carriers Skywest and ASA as part of its agreement with Delta.
(3) Alaska Mileage Plan members can earn miles on Mokulele, but redemption of miles is not currently available.
(4) Our agreement with Northwest will continue to be effective until they cease operation as a separate entity from Delta. At the time that Northwest ceases operation, the agreement with Delta will include those Northwest operations.

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COMPETITION

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

- safety record and reputation,
- flight schedules,
- fares,
- customer service,
- routes served,
- frequent flyer programs,
- on-time arrivals,
- baggage handling,
- on-board amenities,
- type of aircraft, and
- code-sharing relationships.

Together, Alaska and Horizon carry approximately 3.2% of all U.S. domestic passenger traffic. We compete with one or more domestic or foreign airlines on most of our routes, including Southwest Airlines, United Airlines, Delta Air Lines (including Northwest), Continental Airlines, American Airlines, US Airways, JetBlue Airways, Virgin America and regional affiliates associated with some of these carriers. Most of these airlines are larger and have greater financial resources and name recognition than our companies and some have lower operating costs. In addition, competitors that have successfully reorganized out of bankruptcy have lower operating costs derived from renegotiated labor, supply and financing agreements. Some of these competitors have chosen to add service, reduce their fares, or both in our markets. We may be unable to compete effectively against other airlines that introduce service or discounted fares in the markets that we serve. Due to its short-haul markets, Horizon also competes with ground transportation in many markets, including train, bus and automobile transportation.

TICKET DISTRIBUTION

Airline tickets are distributed through three primary channels:

Alaskaair.com. It is less expensive for us to sell through this direct channel and, as a result, we continue to take steps to drive more business to our website. In addition, we believe this channel is preferable from a branding and customer-relationship standpoint in that we can establish ongoing communication with the customer and tailor offers accordingly. In 2008, we processed approximately 45% of our sales through our website, compared to 43% in 2007 a sign of progress toward our goal of transitioning more of our customers to this direct sales channel.

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

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

Our sales by channel are presented below:

	2008	2007
Alaskaair.com	45%	43%
Traditional and online travel agencies	43%	43%
Reservations call center	11%	12%
All other channels	1%	2%
Total	100%	100%

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EMPLOYEES

Labor costs have historically made up 30% to 40% of an airline s total operating costs. Most major airlines, including ours, have employee groups that are covered by collective bargaining agreements. Often, airlines with unionized work forces have higher labor costs than carriers without unionized work forces, and they may not have the ability to adjust labor costs downward quickly enough to respond to new competition. New entrants into the U.S. airline industry generally do not have unionized work forces, which can be a competitive advantage for those airlines. In 2008, we were able to reduce wages and benefits costs compared to 2007, primarily due to a decline in defined benefit pension costs and a decline in the number of full-time equivalent employees (FTEs) at both companies. The reduction in FTEs was driven by a reduction in work forces at both companies to coincide with planned capacity reductions and the improvement in operational performance at both companies that resulted in less overtime pay. However, we expect to see continued upward pressure on wages and benefits in the future due to normal step increases and increased benefits costs, primarily pension and health care costs. We recognize the need to continue to improve employee productivity in order to mitigate this cost pressure and to reduce our wages and benefits on an available-seat-mile basis. Horizon has been successful in improving productivity, when measured as number of passengers per FTE, with year-over-year improvements in 25 of the last 28 quarters.

We had 14,143 (10,250 at Alaska and 3,893 at Horizon) active full-time and part-time employees at December 31, 2008, compared to 14,710 (10,526 at Alaska and 4,184 at Horizon) as of December 31, 2007. Wages, salaries and benefits (including variable incentive pay) represented approximately 40% and 41% of our total non-fuel operating expenses in 2008 and 2007, respectively.

At December 31, 2008, labor unions represented 84% of Alaska s and 49% of Horizon s employees. Our relations with our labor organizations are governed by the Railway Labor Act (RLA). Under this act, collective bargaining agreements do not expire but instead become amendable as of a stated date. If either party wishes to modify the terms of any such agreement, it must notify the other party in the manner prescribed by the RLA and/or described in the agreement. After receipt of such notice, the parties must meet for direct negotiations, and if no agreement is reached, either party may request the National Mediation Board to appoint a federal mediator. If no agreement is reached in mediation, the National Mediation Board may declare that an impasse exists, at which point the National Mediation Board offers binding arbitration to the parties. Either party may decline to submit to arbitration. If either party rejects arbitration, a 30-day cooling-off period commences. During that period, a Presidential Emergency Board may be established, which examines the parties positions and recommends a solution. The Presidential Emergency Board process, if invoked, lasts for 30 days and is followed by another cooling-off period of 30 days. At the end of the applicable cooling-off period, unless an agreement is reached or action is taken by Congress, the labor organization may strike and the airline may resort to self-help, including the imposition of any or all of its proposed amendments on the collective bargaining agreements and/or the hiring of workers to replace strikers.

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Alaska s union contracts at December 31, 2008 were as follows:

Union	Employee Group	Number of Employees	Contract Status
Air Line Pilots Association International (ALPA)	Pilots	1,460	In Negotiations
Association of Flight Attendants (AFA)	Flight attendants	2,839	Amendable 4/27/10
International Association of Machinists and Aerospace Workers (IAM/RSSA)	Ramp service and stock clerks; and Clerk, office and passenger service	3,491	Amendable 7/17/10
Aircraft Mechanics Fraternal Association (AMFA)	Mechanics, inspectors and cleaners	667	Amendable 10/01/09
Mexico Workers Association of Air Transport	Mexico airport personnel	82	Amendable 9/29/09
Transport Workers Union of America (TWU)	Dispatchers	35	Amendable 7/01/10*

* Collective bargaining agreement contains interest arbitration provision.

Horizon s union contracts at December 31, 2008 were as follows:

Union	Employee Group	Number of Employees	Contract Status
International Brotherhood of Teamsters (IBT)	Pilots	695	In Negotiations
AFA	Flight attendants	631	In Negotiations
AMFA	Mechanics and related classifications	494	In Negotiations
TWU	Dispatchers	19	In Negotiations
National Automobile, Aerospace, Transportation and General Workers	Station personnel in Vancouver and Victoria, BC, Canada	78	Expires 2/14/10

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Alaska Air Group, Inc. (including its subsidiaries Alaska and Horizon), their positions and their respective ages (as of February 1, 2009) are as follows:

Name	Position	Age	Air Group or Subsidiary Officer Since
William S. Ayer	Chairman, President and Chief Executive Officer of Alaska Air Group, Inc. and Chairman and Chief Executive Officer of Alaska Airlines, Inc.	54	1985
Bradley D. Tilden	President of Alaska Airlines, Inc.	48	1994
Glenn S. Johnson	Executive Vice President/Finance and Chief Financial Officer of Alaska Air Group, Inc. and Alaska Airlines, Inc.	50	1991
Keith Loveless	Vice President/Legal and Corporate Affairs, General Counsel and Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc.	52	1996
Ben Minicucci	Executive Vice President/Operations and Chief Operating Officer of Alaska Airlines, Inc.	42	2004
Jeffrey D. Pinneo	President and Chief Executive Officer of Horizon Air Industries, Inc.	52	1990
Kelley Dobbs	Vice President/Human Resources Strategy, Culture and Inclusion of Alaska Airlines, Inc.	42	2004
Brandon S. Pedersen	Vice President/Finance and Controller of Alaska Air Group, Inc. and Alaska Airlines, Inc. (Principal Accounting Officer)	42	2003

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

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

Mr. Johnson joined Alaska Airlines in 1982, became Vice President/Controller and Treasurer of Horizon Air Industries in 1991 and Vice President/Customer Services in 2002. He returned to Alaska Airlines in 2003 where he has served in several roles, including Vice President/Finance and Controller and Vice President/Finance and Treasurer. He served as Senior Vice President/Customer Service Airports from January 2006 through April 2007 and in April 2007, he was elected Executive Vice President/Airports and Maintenance and Engineering. He was elected Executive Vice President/Finance and Chief Financial Officer in December 2008. He is a member of Air Group s Executive Committee.

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

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

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

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

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

REGULATION

GENERAL

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

DOT: In order to provide passenger and cargo air transportation in the U.S., a domestic airline is required to hold a certificate of public convenience and necessity issued by the DOT. Subject to certain individual airport capacity, noise and other restrictions, this certificate permits an air carrier to operate between any two points in the U.S. Certificates do not expire, but may be revoked for failure to comply with federal aviation statutes, regulations, orders or the terms of the certificates. In addition,

the DOT has jurisdiction over the approval of international codeshare agreements, alliance agreements between domestic major airlines, international route authorities and certain consumer protection matters, such as advertising, denied boarding compensation and baggage liability. International treaties may also contain restrictions or requirements for flying outside of the U.S.

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

The Aviation and Transportation Security Act (the Security Act) generally provides for enhanced aviation security measures. Pursuant to the Security Act, the Transportation Security Administration (TSA) is responsible for aviation security. The Security Act mandates that the TSA shall provide for the screening of passengers and property, including U.S. mail, cargo, carry-on and checked baggage, and other articles that will be carried aboard a passenger aircraft. The TSA performs most of these functions with its own federal employees. The TSA also provides for increased security on flight decks of aircraft and requires federal air marshals to be present on certain flights. The Security Act imposes a $2.50 per enplanement security service fee (maximum $5.00 one-way fee), which is collected by the air carriers and submitted to the government to pay for these enhanced security measures. In addition, carriers are required to pay an additional amount to the TSA to cover the cost of providing security measures equal to the amount the air carriers paid for screening passengers and property in 2000. We paid $12.6 million each year to the TSA for this security charge in 2008, 2007 and 2006.

The Department of Justice has jurisdiction over airline antitrust matters. The U.S. Postal Service has jurisdiction over certain aspects of the transportation of mail and related services. Labor relations in the air transportation industry are regulated under the Railway Labor Act, which vests in the National Mediation Board (NMB) certain functions with respect to disputes between airlines and labor unions relating to union representation and collective bargaining agreements. To the extent we continue to fly to foreign countries and pursue alliances with international carriers, we may be subject to certain regulations of foreign agencies.

AIRLINE FARES

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

ENVIRONMENTAL MATTERS

We are subject to various laws and government regulations concerning environmental matters and employee safety and health in the U.S. and

other countries. U.S. federal laws that have a particular effect on us include the Airport Noise and Capacity Act of 1990, the Clean Air Act, the

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

The current federal administration will likely move forward in 2009 or 2010 with legislation to reduce carbon and other greenhouse gas emissions. We believe legislation will most likely come in the form of a cap and trade system, under which companies must purchase credits to emit above a specified cap. We do not believe legislation is necessary to motivate airlines to reduce fuel burn and, in turn, reduce emissions. For example, Alaska and Horizon have transitioned or are transitioning to more fuel-efficient single-type aircraft fleets, thereby greatly reducing our total emissions.

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

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

CUSTOMER SERVICE

Along with other domestic airlines, we have implemented a customer service commitment plan to address a number of service goals, including, but not limited to, goals relating to lowest fare availability, delays, cancellations and diversions, baggage delivery and liability, guaranteed fares and ticket refunds. In 2008, we set a goal of having all of our employees attend our Customer Experience Workshop to enhance our customer service focus and ultimately improve the experience our customers have when traveling with us.

There has been some discussion of an airline passenger s bill of rights at both the national and state levels. Bills have been introduced in several states, including the state of Washington, that propose to regulate airlines when operating in those specific states. However, we believe these bills would be preempted by federal law. We do not believe these bills are necessary and if the federal bills were to become law, they could impose additional economic and resource constraints on our airlines and could negatively impact our financial performance.

MILEAGE PLAN PROGRAM

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

Mileage can be redeemed for free or discounted travel and for various other awards. Upon accumulating the necessary mileage, members notify Alaska of their award selection. Over 75% of the free flight awards on Alaska and Horizon are subject to capacity-controlled seating. Beginning in the third quarter of 2008, Mileage Plan accounts are generally deleted after two years of inactivity in a member s account. Prior to that date, accounts were deleted after three years of inactivity. As of December 31, 2008 and 2007, Alaska estimated that approximately 4.0 million and 3.7 million, respectively, round-trip flight awards were eligible for redemption by Mileage Plan members. Of those eligible awards, Alaska estimated that approximately 88% would ultimately be redeemed. For the years 2008 and 2007, approximately 936,000 and 870,000 round-trip awards and 499,000 and 270,000 one-way flight awards were redeemed and flown on Alaska and Horizon. One-way awards were introduced in February 2007. For 2006, approximately 850,000 round-trip flight awards were redeemed and flown on Alaska and Horizon. Those awards represent approximately 12.4%, 9.7%, and 8.6% for 2008, 2007, and 2006, respectively, of the total passenger miles flown on Alaska and Horizon. For the years 2008, 2007, and 2006, approximately 214,000, 243,200, and 252,600, respectively, round-trip flight awards were redeemed and flown on airline partners. Effective in November 2008, we began charging a $25 fee for awards redeemed on our airline partners.

For miles earned through travel on Alaska or Horizon and their airline partners, the estimated incremental cost of providing free travel awards in the future is recognized as a selling expense and accrued as a liability as miles are accumulated. The incremental cost of providing award travel on Alaska or Horizon does not include a contribution to overhead, aircraft ownership cost, or profit. Alaska also sells mileage credits to its non-airline partners. Alaska defers a majority of the sales proceeds and recognizes revenue when award transportation is provided on Alaska, Horizon or another partner airline. At December 31, 2008 and 2007, the deferred revenue and the total liability for providing free travel on Alaska and Horizon and for estimated payments to partner airlines was $690.4 million and $648.5 million, respectively, the majority of which is deferred revenue from the sale of mileage credits. Excluding the $42.3 million benefit from the change in Mileage Plan account activity terms, revenue attributable to the Mileage Plan was $245.7 million, $227.6 million, and $194.2 million in 2008, 2007 and 2006, respectively.

OTHER INFORMATION

SEASONALITY AND OTHER FACTORS

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

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

- general economic conditions and resulting changes in passenger demand,
- pricing initiatives by us and our competitors,
- changes in fuel costs,

- the timing and amount of maintenance expenditures (both planned and unplanned),
- increases or decreases in passenger and volume-driven variable costs, and
- labor actions.

In addition to those factors listed above, seasonal variations in traffic, the timing of various expenditures such as maintenance events and adverse weather conditions may affect our operating results from quarter to quarter. Many of the markets we serve experience inclement weather conditions in the winter, causing increased costs associated with deicing aircraft, canceled flights and reaccommodation of displaced passengers. Due to our geographic area of operations, we can be more susceptible to adverse weather conditions

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(particularly in the state of Alaska and the Pacific Northwest) than some of our competitors, who may be better able to spread weather-related risks over larger route systems.

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

INSURANCE

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

Over the last several years, Alaska Air Group has experienced dramatic reductions in the cost of its Airline Hull, Spares and Comprehensive Legal Liability Insurance program through a combination of factors. These factors include a general softening of aviation insurance market conditions, demonstration of Alaska Air Group s state-of-the-art safety program to insurers and better alignment with industry rates designed to improve costs and support in the aviation insurance market.

OTHER GOVERNMENT MATTERS

We have elected to participate in the Civil Reserve Air Fleet program, whereby we make available to the federal government a certain number of aircraft in the event of a military call-up. The government would reimburse us for the use of such aircraft. Participation in the program is a prerequisite for bidding on various government travel contracts.

ITEM 1A. RISK FACTORS

We have established an ongoing Risk Analysis and Oversight Program to identify and assign responsibility for the most significant risks facing our company. The results of this program are routinely shared with our Board of Directors. In this section, we discuss the highest priority issues identified in our risk analysis. If any of the following occurs, our business, financial condition and results of operations could suffer. In such case, the trading price of our common stock could also decline. These risk factors may not be exhaustive. We operate in a continually changing business environment and new risk factors emerge from time to time. Management cannot predict such 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.

The current economic recession will impact demand for our product and could harm our financial condition and results of operations.

The current economic recession and outlook has resulted in a decline in demand for air travel. Our passenger count and traffic declined in the fourth quarter when compared to the prior year periods and we anticipate declines into 2009. We are reducing 2009 capacity at both Alaska and Horizon by 8% and 9%, respectively, when compared to 2008 to help offset this anticipated decline in passenger traffic, which will likely result in a decline in operating revenues. If demand declines further than expected, it will harm our business, financial condition and results of operations.

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

We have, and will continue to have for the foreseeable future, a significant amount of debt. Due to our high fixed costs, including aircraft lease commitments and debt service, a decrease in revenues results in a disproportionately greater decrease in earnings. As of December 31, 2008 and 2007, we had approximately $1.8 billion and $1.3 billion of

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long-term debt outstanding, respectively, all of which is secured by flight equipment, aircraft purchase rights and real property. In addition to long-term debt, we have significant other fixed obligations under operating leases related to our aircraft, airport terminal space, other airport facilities and office space. As of December 31, 2008, future minimum lease payments under noncancelable operating leases with initial or remaining terms in excess of one year were approximately $1.0 billion for 2009 through 2013 and an aggregate of approximately $400 million for the years thereafter.

At December 31, 2008, we had firm orders to purchase 33 aircraft requiring future aggregate payments of $753.4 million through 2011. Although we have secured financing for all of the firm Q400 commitments, there is no guarantee that additional financing will be available for our other aircraft deliveries when required or that the terms will be acceptable to us. The current market conditions could result in a lack of availability or higher interest rates for financing of aircraft purchases, which would harm our business, financial condition and results of operations.

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

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

We cannot ensure that we will be able to generate sufficient cash flow from our operations to pay our debt and other fixed obligations as they become due. If we fail to do so, our business could be harmed.

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

Our failure to successfully reduce unit costs at both Alaska and Horizon could harm our business.

We continue to strive toward aggressive cost-reduction goals that are an important part of our business strategy of offering the best value to passengers through competitive fares while achieving acceptable profit margins and return on capital. We believe having a lower cost structure better positions us to be able to fund future growth and take advantage of market opportunities, if economic conditions allow. However, with our planned capacity reductions, we will see upward pressure on unit costs, at least in the near term. Furthermore, if Horizon is unable to successfully transition to an all-Q400 fleet, it will be more difficult to reach our unit cost goals as the remaining Q200 and CRJ-700 aircraft are more costly to operate on a per-unit basis. If we are unable to further reduce our non-fuel unit costs over the long-term and achieve targeted profitability, we will likely not be able to grow our business in the future and therefore our financial results may suffer.

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

Fuel costs constitute a significant portion of our total operating expenses, accounting for 36% and 27% of total operating expenses for the years ended December 31, 2008 and 2007, respectively. Significant increases in average fuel costs during the past several years have negatively affected our results of operations. Although prices have declined sharply over the past six months, prices are still substantially higher than they were earlier in this decade. Future increases in the price of jet fuel will harm our financial condition and results of operations, unless we are able to increase fares or add additional ancillary fees to attempt to recover increasing fuel costs.

Historically, fuel costs and availability have been unpredictable and subject to wide price fluctuations based on geopolitical issues and supply and demand. It is often difficult to increase fares to offset increases in the price of fuel and although we had some success recently, we may not be able to do so in the future.

We utilize fuel hedges as a form of insurance against the volatility of fuel prices. To manage the risk of fuel price increases, we primarily purchase call options that are designed to cap a portion of our fuel costs at designated per-barrel oil prices. Even with hedges, we are substantially and increasingly exposed to increases in jet fuel costs as the average price at which we are hedged in future periods is higher than it has historically been.

The airline industry is highly competitive and subject to rapid change. We may be unable to compete effectively against other airlines with greater financial resources or lower operating costs, or to adjust rapidly enough in the event the nature of competition in our markets changes.

The airline industry is highly competitive as to fares, flight frequency, frequent flyer benefits, routes and service. The industry is particularly susceptible to price discounting because airlines incur only nominal costs to provide service to passengers occupying otherwise unsold seats. Over the past few years, airlines have reduced domestic routes and the number of planes available, which has resulted in reduced domestic industry capacity and a trend towards increased fares. Although capacity has declined based on a nationwide average, capacity on the West Coast has not declined to the same degree due to increased competition from new market entrants. If airlines decide to increase their capacity in the future, this could cause fares to decline, which may adversely affect our business and results of operations. Many of our competitors are larger than we are and therefore, may have significantly greater financial resources and name recognition or lower operating costs than we do. In addition, competitors who have successfully reorganized out of bankruptcy have lowered their operating costs as a result of renegotiated labor, supply and financing agreements. From time to time in the past, some of these competitors have chosen to add service, reduce their fares, or take other competitive steps in our key markets. We may be unable to compete effectively against other airlines that introduce service or discounted fares in the markets that we serve.

The airline industry, and particularly regional airlines like Horizon, also faces competition from ground transportation alternatives, such as buses, trains or automobiles. Increased use of technology such as video conferencing and internet-based meeting tools have also resulted in a change in business travel, especially in short-haul markets like those that Horizon serves.

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

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

Labor costs are a significant component of our total expenses, accounting for approximately 25% and 30% of our total operating expenses in 2008 and 2007, respectively. As of December 31, 2008, labor unions represented approximately 84% of Alaska s and 49% of Horizon s employees. Each of our represented employee groups has a separate collective bargaining agreement, and could

make demands that would increase our operating expenses and adversely affect our financial performance if we agree to them. Uncertainty around open contracts could be a distraction to many employees, reduce employee engagement in our business and divert management s attention from other projects and issues. Disengaged

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employees could prevent us from achieving the operational improvements in completion rate and on-time performance that we seek.

In 2005, Alaska and the Air Line Pilots Association (ALPA) were unable to reach a new agreement, and therefore, pursuant to the terms of the collective bargaining agreement that existed at the time, the parties submitted the agreement to binding arbitration. That arbitration decision, which was effective May 1, 2005, resulted in an average pilot wage reduction of 26%. That contract became amendable on May 1, 2007, and Alaska has been in negotiations with ALPA. In 2008, ALPA requested mediation from the National Mediation Board (NMB) in order to assist with contract negotiations. We have begun meeting with the NMB and hope to reach a negotiated contract that recognizes the important contributions that our pilots make while not harming our competitive position. Horizon is also in negotiations with the International Brotherhood of Teamsters on a new pilot agreement. The Horizon pilot contract became amendable in September 2006. Factoring in pay rates, productivity measures, and pension and postretirement medical benefits, we believe our pilot unit costs at both Alaska and Horizon are among the highest in the industry for the size of aircraft we operate.

Our continuing obligation to fund our traditional defined-benefit pension plans could negatively affect our ability to compete in the marketplace. This is because most of our competitors either have eliminated such obligations through bankruptcy or have never had traditional pension plans in place. Currently, all of our defined-benefit pension plans are closed to new entrants, with the exception of the plan covering Alaska s pilots.

Our defined-benefit pension plan assets are subject to market risk. If market returns are poor in the future, as they were in 2008, our obligation to make additional cash contributions in accordance with the Pension Plan Act of 2006 could increase and harm our liquidity. Poor market returns also lead to higher pension expense in our statement of operations. The calculation of pension expense is dependent on many assumptions that are more fully described in Critical Accounting Estimates on page 52 and Note 8 to our consolidated financial statements.

Finally, to the extent we are unable to maintain the outsourcing or subcontracting of certain services for our business, we would incur substantial costs, including costs associated with hiring new employees, in order to perform these services in-house.

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

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

- air traffic congestion at airports or other air traffic control problems;
- adverse weather conditions;
- increased security measures or breaches in security; and

international or domestic conflicts, terrorist activity, or other changes in business conditions.

Delays and cancellations frustrate passengers, reduce aircraft utilization and increase costs, all of which affect our profitability. Due to our geographic area of operations, we believe a significant portion of our operation is more susceptible to adverse weather conditions than that of many of our competitors. A general reduction in airline passenger traffic as a result of any of the above-mentioned factors could harm our business, financial condition and results of operations.

We depend on a few key markets to be successful.

Our strategy is to focus on serving a few key markets, including Seattle, Portland, Los Angeles and Anchorage. A significant portion of our flights occurs to and from our Seattle hub. In 2008, passengers to and from Seattle accounted for 62% of our total passengers.

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

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

The terrorist attacks of September 11, 2001 and their aftermath negatively affected the airline industry, including our company. These attacks and other foiled terror plots since then have resulted in new security measures that also impacted our company. Additional terrorist attacks, the fear of such attacks or other hostilities involving the U.S. could have a further significant negative effect on the airline industry, including us, and could:

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

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

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

With respect to the availability of commercial War and Allied Perils Insurance, world events or events involving our company could result in sudden market volatility resulting in cancellation and/or a material change in the availability or cost of the coverage which could adversely affect ongoing operations or results. Further, commercial War and Allied Perils Insurance now excludes certain catastrophic perils not previously excluded for weapons of mass destruction (such as chemical, biological or nuclear devices). The commercial policies also contain low aggregate sublimits, which do not adequately address potential catastrophic third-party war and allied perils exposures. In the event we were to be required to rely on the commercial insurance market, expensive excess limits would likely need to be explored in an equally volatile excess specialty market. It remains, therefore, our position to retain our coverage for this aspect of the insurance program directly through the U.S. government s FAA premium war risk insurance program,

rather than procure it from the commercial market.

Although our insurance costs have declined significantly, aviation insurers could increase their premiums again in the event of additional terrorist attacks, hijackings, airline accidents or other events adversely affecting the airline industry. Furthermore, the full hull and liability war risk insurance provided by the government is currently mandated through March 31, 2009. Although the government may extend the deadline for providing such coverage, we cannot be certain that any extension will occur, or if it does, for how long the extension will last. It is expected that, should the government stop providing such coverage to the airline industry, the premiums charged by aviation insurers for this coverage will be substantially higher than the premiums currently charged by the government and the coverage will be much more limited, including smaller aggregate limits and shorter cancellation periods. Significant increases in insurance premiums would adversely affect our business, financial condition and results of operations.

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

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

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

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

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

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

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

We have historically relied on outside vendors for a variety of services and functions critical to our business, including airframe and engine maintenance, ground handling, fueling, computer reservation system hosting and software maintenance. As part of our cost-reduction efforts, our reliance on outside vendors has increased and may continue to do so in the future. In recent years,

Alaska has subcontracted its heavy aircraft maintenance, fleet service, facilities maintenance, and ground handling services at certain airports, including Seattle-Tacoma International Airport, to outside vendors.

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

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

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

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

Airlines are subject to extensive regulatory and legal requirements, both domestically and internationally, that involve significant compliance costs. In the last several years, Congress has passed laws, and the U.S. Department of Transportation, the Transportation Security Administration and the Federal Aviation Administration (the FAA) have issued regulations that have required significant expenditures relating to the maintenance and operation of airlines. For example, the FAA has issued regulations covering, among other things, security measures, collision avoidance systems, noise abatement, environmental restrictions, safety procedures and maintenance regulations. Similarly, many aspects of an airline s operations are subject to increasingly stringent federal, state and local laws protecting the environment.

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

The market price of our common stock may be volatile.

The market price of our stock can be influenced by many factors, a number of which are outside of our control, including those discussed above. Some of the primary factors in the volatility of our stock price are:

- our actual or anticipated financial performance;
- the price of crude oil;
- the overall financial performance of the industry; and
- other industry, macro or geopolitical factors.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

AIRCRAFT

The following tables describe the aircraft we operate and their average age at December 31, 2008:

Aircraft Type	Passenger Capacity	Owned	Leased	Total	Average Age in Years
Alaska Airlines					
Boeing 737-400	144	3	28	31	13.3
Boeing 737-400C*	72	5		5	16.3
Boeing 737-400F*		1		1	9.8
Boeing 737-700	124	17	3	20	8.0
Boeing 737-800	157	37	4	41	1.7
Boeing 737-900	172	12		12	6.4
Total		75	35	110	7.3
Horizon Air					
Bombardier Q200	37		6	6	11.6
Bombardier Q400	74 76	20	15	35	4.7
Bombardier CRJ-700	70	2	16	18	6.3
Total		22	37	59	5.8

* C=Combination freighter/passenger; F=Freighter

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

As of December 31, 2008, 59 of the 75 aircraft owned by Alaska and three of the 22 aircraft owned by Horizon are subject to liens securing long-term debt, and the majority of the other owned Alaska aircraft serve as collateral for our $185 million line-of-credit facility. Alaska s leased 737-400, 737-700, and 737-800 aircraft have lease expiration dates between 2009 and 2016, between 2009 and 2010, and between 2015 and 2018, respectively. Additionally, Alaska has four MD-80 aircraft under long-term lease arrangements through 2012 that are currently in temporary storage. Horizon s leased Q200, Q400 and CRJ-700 aircraft have expiration dates in 2012, in 2018, and between 2018 and 2020, respectively. Alaska and Horizon have the option to extend most of the leases for additional periods, or the right to purchase the aircraft at the end of the lease term, usually at the then-fair-market value of the aircraft.

Alaska completed its transition to an all-Boeing fleet during 2008. Horizon continues to progress in its plan to transition to an all-Q400 fleet as quickly and efficiently as possible, depending on the ability to successfully market the CRJ-700 aircraft.

Giving consideration to these fleet transition plans and Alaska s plan to sell up to four B737-700 aircraft in 2009, the following table displays the currently anticipated fleet counts for Alaska and Horizon as of the end of each quarter in 2009. The Horizon fleet totals are fluid given the CRJ-700 remarketing efforts and are likely to change.

	31-Mar-09	**30-Jun-09**	**30-Sep-09**	**31-Dec-09**
Alaska Airlines				
737-400	28	28	28	28
737-400C*	5	5	5	5
737-400F*	1	1	1	1
737-700	18	15	15	15
737-800	47	51	51	51
737-900	12	12	12	12
Totals	111	112	112	112
Horizon Air				
Q200				
Q400	37	37	37	40
CRJ-700	18	18	17	13
Totals	55	55	54	53

* C=Combination freighter/passenger; F=Freighter

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GROUND FACILITIES AND SERVICES

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

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

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

ITEM 3. LEGAL PROCEEDINGS

Grievance with International Association of Machinists

In June 2005, the International Association of Machinists (IAM) filed a grievance under its Collective Bargaining Agreement (CBA) with Alaska alleging that Alaska violated the CBA by, among other things, subcontracting the ramp service operation in Seattle. The dispute was referred to an arbitrator and hearings on the grievance commenced in January 2007, with a final hearing date in August 2007. In August 2008, the arbitrator issued a ruling in the matter. In that ruling, the arbitrator found that Alaska had violated the CBA and instructed Alaska and the IAM to negotiate a remedy. The parties have met, but the matter has not yet been resolved. Another arbitration hearing has been tentatively set for June 2009. Management currently does not believe that any final remedy will materially impact our financial position or results of operations.

Other items

The Company is a party to routine litigation matters incidental to its business and with respect to which no material liability is expected.

Management believes the ultimate disposition of any of the matters discussed above is not likely to materially affect the Company s 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 arbitrators, judges and juries.

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

None

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PART II

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

As of December 31, 2008, there were 36,274,898 shares of common stock of Alaska Air Group, Inc. issued and outstanding and 3,485 shareholders of record. We also held 6,896,506 treasury shares at a cost of $161.4 million. We have not paid dividends on the common stock since 1992 and have no plans to do so in the foreseeable future. Our common stock is listed on the New York Stock Exchange (symbol: ALK).

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

	2008		2007	
	High	**Low**	**High**	**Low**
First Quarter	**$ 28.56**	**$ 17.44**	$ 44.52	$ 36.56
Second Quarter	**23.00**	**15.34**	38.99	25.90
Third Quarter	**24.68**	**10.10**	29.09	21.50
Fourth Quarter	**29.74**	**12.89**	28.00	21.15

SALES OF NON-REGISTERED SECURITIES

None

PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

	Total Number of Shares Purchased	Average Price Paid per Share	Maximum remaining dollar value of shares that can be purchased under the plan
January 1, 2008 January 31, 2008 (1)	869,900	$ 23.49	
February 1, 2008 February 29, 2008 (1)	574,100	$ 25.94	
March 1, 2008 March 18, 2008 (1)	76,800	$ 25.42	
March 19, 2008 March 31, 2008 (2)	175,000	$ 18.98	
April 1, 2008 April 30, 2008 (2)	430,700	$ 19.40	

Total	2,126,500	$	23.02	$	38,322,441

(1) Purchased pursuant to a $100 million repurchase plan authorized by the Board of Directors in September 2007. The total number of shares purchased under this plan was 4,113,782. This plan has terminated and no further shares will be purchased under this plan.

(2) Purchased pursuant to a $50 million repurchase plan authorized by the Board of Directors in March 2008. The plan expires after twelve months. The remaining dollar value of shares that can be purchased is solely under this $50 million plan. The Company has temporarily ceased further purchases under this program given the uncertainty in the economic environment and currently does not expect to repurchase any more shares prior to the expiration date.

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PERFORMANCE GRAPH

The following graph compares our cumulative total stockholder return since December 31, 2003 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, 2003.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

	2008	2007	2006	2005	2004
Consolidated Operating Results					
Year Ended December 31 (in millions, except per share amounts):					
Operating Revenues	**$ 3,662.6**	$ 3,506.0	$ 3,334.4	$ 2,975.3	$ 2,723.8
Operating Expenses	**3,834.8**	3,295.1	3,424.6	2,808.8	2,718.1
Operating Income (Loss)	**(172.2)**	210.9	(90.2)	166.5	5.7
Nonoperating income (expense), net of interest capitalized (a)	**(41.0)**	(10.4)	(0.5)	(29.3)	(26.3)
Income (loss) before income tax and accounting change	**(213.2)**	200.5	(90.7)	137.2	(20.6)
Income (loss) before accounting change	**(135.9)**	124.3	(54.5)	84.5	(15.3)
Net Income (Loss)	**$ (135.9)**	$ 124.3	$ (54.5)	$ (5.9)	$ (15.3)
Average basic shares outstanding	**36.343**	40.125	37.939	27.609	26.859
Average diluted shares outstanding	**36.343**	40.424	37.939	33.917	26.859
Basic earnings (loss) per share before accounting change	**$ (3.74)**	$ 3.10	$ (1.44)	$ 3.06	$ (0.57)
Basic earnings (loss) per share	**(3.74)**	3.10	(1.44)	(0.21)	(0.57)
Diluted earnings (loss) per share before accounting change	**(3.74)**	3.07	(1.44)	2.65	(0.57)
Diluted earnings (loss) per share	**(3.74)**	3.07	(1.44)	(0.01)	(0.57)
Consolidated Financial Position					
At End of Period (in millions, except ratio):					
Total assets	**$ 4,835.6**	$ 4,490.9	$ 4,077.1	$ 3,792.0	$ 3,335.0
Long-term debt and capital lease obligations, net of current portion	**1,596.3**	1,124.6	1,031.7	969.1	989.6
Shareholders equity	**661.9**	1,025.4	886.5	827.6	664.8
Ratio of earnings to fixed charges (b)	**(0.11)**	1.90	0.40	1.78	0.89
Statistics					
Alaska Airlines Mainline Operating Data:					
Revenue passengers (000)	**16,809**	17,558	17,165	16,759	16,295
Revenue passenger miles (RPM) (000,000)	**18,712**	18,451	17,822	16,915	16,231
Available seat miles (ASM) (000,000)	**24,218**	24,208	23,278	22,292	22,276
Revenue passenger load factor	**77.3%**	76.2%	76.6%	75.9%	72.9%
Yield per passenger mile	**14.13¢**	13.81¢	13.76¢	12.91¢	12.47¢
Operating revenues per ASM	**12.06¢**	11.52¢	11.50¢	10.76¢	10.02¢
Operating expenses per ASM	**12.54¢**	10.55¢	11.93¢	10.14¢	10.07¢
Average number of full-time equivalent employees	**9,628**	9,679	9,322	9,065	9,968
Operating fleet at period-end	**110**	115	114	110	108
Horizon Air Combined Operating Data (c):					
Revenue passengers (000)	**7,390**	7,552	6,860	6,481	5,930
Revenue passenger miles (RPM) (000,000)	**2,635**	2,918	2,691	2,475	2,155
Available seat miles (ASM) (000,000)	**3,617**	3,978	3,632	3,400	3,107
Revenue passenger load factor	**72.9%**	73.4%	74.1%	72.8%	69.3%
Yield per passenger mile	**27.43¢**	24.30¢	23.53¢	21.98¢	22.61¢
Operating revenues per ASM	**20.29¢**	18.06¢	17.73¢	16.36¢	16.20¢
Operating expenses per ASM	**21.42¢**	18.07¢	17.41¢	15.50¢	15.57¢
Average number of full-time equivalent employees	**3,699**	3,897	3,611	3,456	3,423
Operating fleet at period-end	**59**	70	69	65	65

(a) Includes capitalized interest of $23.2 million, $27.8 million, $24.7 million, $8.9 million, $1.7 million, $2.3 million, $2.7 million, $10.6 million, $17.7 million, $12.6 million, and $7.0 million for 2008, 2007, 2006, 2005, 2004, 2003, 2002, 2001, 2000, 1999, and 1998 respectively.

(b) For 2008, 2006, 2004, 2002, 2001, and 2000 earnings are inadequate to cover fixed charges by $229.9 million, $110.5 million, $17.4 million, $99.5 million, $69.1 million, and $44.6 million, respectively. See Exhibit 12.1 to this Form 10-K.

(c) Includes Horizon services operated as Frontier JetExpress in 2004 through 2007 and flights operated under the Capacity Purchase Agreement with Alaska in 2007 and 2008.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA (Continued)

	2003	2002	2001	2000	1999	1998
Consolidated Operating Results						
Year Ended December 31 (in millions, except per share amounts):						
Operating Revenues	$ 2,444.8	$ 2,224.1	$ 2,152.8	$ 2,194.0	$ 2,091.5	$ 1,912.0
Operating Expenses	2,455.9	2,317.3	2,279.1	2,227.1	1,901.7	1,700.1
Operating Income (Loss)	(17.5)	(93.2)	(126.3)	(33.1)	189.8	211.9
Nonoperating income (expense), net of interest capitalized (a)	46.5	(8.6)	62.8	6.2	23.2	(6.2)
Income (loss) before income tax and accounting change	29.0	(101.8)	(63.5)	(26.9)	213.0	205.7
Income (loss) before accounting change	13.5	(67.2)	(43.4)	(20.4)	129.4	125.3
Net Income (Loss)	$ 13.5	$ (118.6)	$ (43.4)	$ (67.2)	$ 129.4	$ 125.3
Average basic shares outstanding	26.648	26.546	26.499	26.440	26.372	23.388
Average diluted shares outstanding	26.730	26.546	26.499	26.440	26.507	26.367
Basic earnings (loss) per share before accounting change	$ 0.51	$ (2.53)	$ (1.64)	$ (0.77)	$ 4.91	$ 5.36
Basic earnings (loss) per share	0.51	(4.47)	(1.64)	(2.54)	4.91	5.36
Diluted earnings (loss) per share before accounting change	0.51	(2.53)	(1.64)	(0.77)	4.88	4.75
Diluted earnings (loss) per share	0.51	(4.47)	(1.64)	(2.54)	4.88	4.75
Consolidated Financial Position						
At End of Period (in millions, except ratio):						
Total assets	$ 3,259.2	$ 2,880.7	$ 2,950.5	$ 2,528.1	$ 2,196.0	$ 1,742.6
Long-term debt and capital lease obligations, net of current portion	906.9	856.7	852.2	509.2	337.0	171.5
Shareholders equity	674.2	655.7	851.3	895.1	959.2	822.1
Ratio of earnings to fixed charges (b)	1.22	0.28	0.48	0.66	3.07	2.94
STATISTICS						
Alaska Airlines Mainline Operating Data:						
Revenue passengers (000)	15,047	14,154	13,668	13,525	13,620	13,056
Revenue passenger miles (RPM) (000,000)	14,554	13,186	12,249	11,986	11,777	11,283
Available seat miles (ASM) (000,000)	20,804	19,360	17,919	17,315	17,341	16,807
Revenue passenger load factor	70.0%	68.1%	68.4%	69.2%	67.9%	67.1%
Yield per passenger mile	12.65¢	12.65¢	13.12¢	13.56¢	12.86¢	12.51¢
Operating revenues per ASM	9.74¢	9.47¢	9.84¢	10.20¢	9.75¢	9.41¢
Operating expenses per ASM	9.81¢	9.87¢	10.24¢	10.35¢	9.81¢	8.25¢
Average number of full-time equivalent employees	10,040	10,142	10,115	9,611	9,183	8,704
Operating fleet at period-end	109	102	101	95	89	84
Horizon Air Combined Operating Data (c):						
Revenue passengers (000)	4,934	4,815	4,668	5,044	4,984	4,389
Revenue passenger miles (RPM) (000,000)	1,640	1,514	1,350	1,428	1,379	1,143
Available seat miles (ASM) (000,000)	2,569	2,428	2,148	2,299	2,194	1,815
Revenue passenger load factor	63.9%	62.4%	62.8%	62.1%	62.9%	63.0%
Yield per passenger mile	26.96¢	26.02¢	28.15¢	29.82¢	28.77¢	29.02¢
Operating revenues per ASM	18.06¢	17.29¢	19.02¢	19.27¢	18.96¢	19.16¢
Operating expenses per ASM	17.79¢	17.87¢	21.02¢	19.53¢	17.74¢	18.16¢
Average number of full-time equivalent employees	3,361	3,476	3,764	3,795	3,603	3,019
Operating fleet at period-end	62	63	60	62	62	60

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

OVERVIEW

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

Year in Review highlights from 2008 outlining some of the major events that happened during the year and how they affected our financial performance.

Results of Operations an in-depth analysis of the results of operations of Alaska and Horizon for the three years presented in our consolidated financial statements. We believe this analysis will help the reader better understand our consolidated statements of operations. Financial and statistical data for Alaska and Horizon are also included here. This section includes forward-looking statements regarding our view of 2009.

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

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

YEAR IN REVIEW

In 2008, we reported a consolidated net loss of $135.9 million compared to a consolidated net income of $124.3 million in 2007. The largest driver of the decline in results was fuel expense. Our fuel expense increased by $522.1 million over 2007, primarily as a result of the significantly higher average fuel prices in 2008. Oil prices reached record levels during the summer months, but declined sharply in the last few months of 2008. Even with the benefit of $122.7 million of net cash settlements from our fuel hedge program during the year, our economic fuel cost (as defined on page 39) increased $277.6 million, or 30%, on a 4.4% decline in fuel gallons consumed. This increase in fuel expense far exceeded the $156.6 million increase in total operating revenues. We also had the following notable items during 2008:

revenue of $42.3 million associated with the change in Mileage Plan terms to delete accounts that have had no activity for two or more years. Previously, accounts could remain inactive for three years prior to deletion.

fleet transition costs of $71.2 million compared to $14.1 million in 2007.

restructuring charges of $12.9 million associated with reductions in work force.

The revenue environment in 2008 was characterized by increased competition in our West Coast market and softer demand in the last half of the year due to the current economic recession. Yield at both companies improved over 2007 as we and other carriers added or increased ancillary fees and raised fares to cover higher fuel costs. Alaska posted slightly higher passenger traffic for the full year and Horizon posted a sharp decline in passenger traffic. All of these factors, along with a one-time $42.3 million benefit from changes in our Mileage Plan program, resulted in an increase in total consolidated operating revenues of $156.6 million.

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Our total operating expenses increased by $539.7 million during 2008 compared to 2007, primarily as a result of the significant increase in fuel costs along with an increase in fleet transition costs and restructuring charges. This increase is offset by declines in non-fuel operating costs at both companies as we continued to make progress in our cost reduction efforts. See Results of Operations below for further discussion of changes in revenues and operating expenses for both Alaska and Horizon.

Accomplishments and Highlights

Accomplishments and highlights from 2008 include:

- Alaska and Horizon both improved their operational performance in 2008 as measured by on-time arrivals and completion rate. For the full year, Alaska reported an on-time performance and completion rate of 78.3% and 99.2%, respectively, compared to 72.4% and 99.0%, respectively, for 2007. Similarly, Horizon reported a 2008 on-time performance and completion rate of 83.1% and 97.9%, respectively, compared to 80.7% and 97.6% in 2007.

- Alaska received the J.D. Power and Associates Highest Customer Satisfaction award in 2008 among North America Airlines in a tie with Continental Airlines.

- Alaska won the 2007 Program of the Year Freddie award for our Mileage Plan program in 2008.

- We reached an enhanced long-term agreement with Delta that will benefit our customers as it makes us Delta s preferred partner on the West Coast. Other benefits include enhanced frequent flyer and lounge reciprocity agreements.

- We completed our Airport of the Future at Seattle-Tacoma International Airport, reducing customer wait times significantly.

- The cargo business generated over $100 million of consolidated revenue for the first time in 2008.

Alaska Fleet Transition

We completed our transition to an all-B737 fleet in 2008 as our final MD-80 aircraft were removed from service during the year. We now have one of the youngest, most fuel-efficient fleets in the industry.

We have four MD-80 aircraft under long-term lease arrangements that were retired prior to the end of their lease terms and placed in temporary storage at an aircraft storage facility. As a result of their grounding, we recorded a $47.5 million charge during 2008 associated with these aircraft representing the remaining obligation under the existing lease contracts.

Horizon Fleet Transition

Horizon is in the process of transitioning to an all-Q400 fleet and expects to complete the transition as soon as the CRJ-700 fleet is successfully remarketed. At the beginning of 2008, we had 17 Q200s in the fleet, of which we were able to remarket all but six through sublease agreements or arranged sales of the aircraft to third parties. The total charge during 2008 related to the removal of these aircraft from operation was $10.2 million, which represents the estimated sublease loss for five aircraft delivered under the sublease arrangement and the loss on the termination of the underlying leases of six additional aircraft. Although we removed all remaining Q200 aircraft from scheduled operations as of the end of 2008, six of the aircraft were used as spares through the end of January 2009. We are actively remarketing these remaining aircraft. We do not currently know the timing or amount of any associated charge.

In the first quarter of 2008, our Board of Directors approved the plan to remove our CRJ-700 fleet from operations, in addition to the Q200 transition described above. As a result of the decision, the Company determined that its two owned CRJ-700s were impaired and recorded an impairment charge on the aircraft and their related spare parts of $5.5 million in 2008 to reduce the carrying value of these assets to their estimated fair value. Additionally, during 2008, we recorded severance charges of $1.3 million

related to this fleet transition. We are currently evaluating various alternatives to dispose of our CRJ-700 aircraft in the most economically feasible way. Two of our 18 leased aircraft were subleased to a third party during the fourth quarter, resulting in an estimated sublease loss of $6.7 million. The current economic conditions are hindering the remarketing effort and could result in further delays of the timeline to transition completely to an all-Q400 fleet. As such, the nature, timing or amount of any potential gain or loss associated with transactions on the remaining aircraft cannot be reasonably estimated at this time.

Fuel Hedging

We utilize primarily crude oil call options to decrease our exposure to the volatility of jet fuel prices, although we do have some collar structures that are scheduled to settle in 2009. The total outstanding liability for the collar contracts at December 31, 2008 is approximately $24 million, and we currently do not have any collateral on deposit with counterparties to these agreements. With call option contracts, we benefit from the decline in crude oil prices, as there is no future cash exposure above the premiums that we pay to enter into the contracts.

In the fourth quarter of 2008, we restructured our hedge portfolio to take advantage of lower fuel prices. We were able to reduce our 2009 average strike price from $103 per barrel at the end of the third quarter of 2008 to $76 per barrel for 50% of the planned 2009 consumption. As part of this restructuring effort, we terminated some of the previously held contracts. We realized losses on the termination of these contracts of $41.5 million and $8.5 million at Alaska and Horizon, respectively, representing the difference between the original premiums paid to purchase those contracts and the cash received from the counterparty upon termination. We believe that restructuring the hedge portfolio was a wise use of our resources and consistent with our stated objective of managing volatility.

Operational Performance

Our core promise to our customers is to get them and their bags to their destinations safely and on time. Operational performance was a top initiative in 2008 and we believe we made significant progress during the year. For 2008, Alaska and Horizon both exceeded their prior-year performance in on-time arrivals and in schedule completion rates. As a result of the current-year performance, our employees received higher payouts under our Operational Performance Rewards program.

Fees and Mileage Plan Changes

Like many of our competitors, we have increased existing fees or implemented new fees in an effort to increase our revenues. Examples include:

- increasing the charge for booking through reservations and airport sales agents from $10 to $15,
- raising the fee for overweight baggage from $25 to $50,

increasing the charge for transporting pets in the cabin from $75 to $100 one-way, and

raising the unaccompanied minor fee from $30 to $75 for one-way nonstop flights and from $60 to $75 for connecting flights.

The increases above were effective May 21, 2008. We also began charging $25 for a second checked bag effective July 1, 2008. First class and top-tier Mileage Plan members and customers on flights within the state of Alaska are exempt from the new fee.

On July 24, 2008 we announced a $25 fee for booking Mileage Plan award travel on partner airlines. We also announced that our domestic round-trip Coach Saver award will increase to 25,000 miles from 20,000 miles, and we have expanded our 15,000-mile Intra-Alaska award levels in coach to an Intra-State award. This award offers travel wholly within one state for 15,000 award miles. Other changes include an increase in the award miles needed for Peak awards and the introduction of a three-tier award level structure. All of these changes are effective for awards redeemed on or after November 19, 2008.

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Additionally, beginning in August 2008, we reduced from three years to two years the length of time that a Mileage Plan account could be inactive before the account is deleted. As a result of this change in terms, our Mileage Plan liability was reduced by $42.3 million. This benefit is recorded separately in operating revenues as Change in Mileage Plan terms.

Update on Labor Negotiations

Alaska is currently in negotiations with its pilots and has been since early 2007. The contract with Alaska s pilots became amendable on May 1, 2007. The Air Line Pilots Association (ALPA) at Alaska has requested mediation from the National Mediation Board (NMB) in order to assist with contract negotiations. We have begun meeting with the NMB and hope to reach a negotiated contract that recognizes the important contributions that our pilots make while not harming our competitive position. Factoring in pay rates, productivity measures, pension, and post-retirement medical benefits, we believe our pilot unit costs are among the highest in the industry for the size of aircraft operated.

Alaska and the Association of Flight Attendants have reached a tentative agreement to extend the current contract with Alaska s flight attendants by two years. The current agreement becomes amendable on May 1, 2010. Horizon is currently in negotiations with the following work groups pilots, flight attendants, technicians and dispatchers.

We do not know what the final outcome of these negotiations will be or when agreements will be reached. However, uncertainty around open contracts could distract some employees, reduce employee engagement in our business, and prevent us from achieving the operational goals (such as on-time and completion-rate targets) that we have set.

Common Stock Repurchase

In September 2007, our Board of Directors authorized the Company to repurchase up to $100 million of our common stock over a twelve-month period. We completed the repurchase in February 2008 buying back 4.1 million shares of our outstanding common stock, or 10% of the outstanding stock at the start of the program, at an average price of $24.31 per share. During the first quarter of 2008, we repurchased 1.5 million shares for approximately $37.2 million. On March 13, 2008, we announced a new $50 million common stock repurchase program. Through April 24, 2008, we had repurchased 605,700 shares of our common stock for approximately $11.7 million under this new program. The repurchased shares have been recorded as treasury shares in our condensed consolidated balance sheets.

We temporarily stopped further repurchases under this program given the uncertainty in the economic environment and currently do not expect to repurchase any more shares prior to the expiration date in March 2009.

Line of Credit Modification

Alaska has a $185 million variable-rate credit facility that expires in March 2010. In the fourth quarter we borrowed $75 million from this facility and that amount was outstanding at December 31, 2008. On September 24, 2008, we entered into the Fourth Amendment to our $185 million variable-rate credit facility that eliminated all previous financial covenants and replaced them with a requirement to maintain a minimum unrestricted cash and marketable securities balance of $500 million.

Outlook

As we look forward to 2009, the two primary uncertainties are the demand environment and fuel prices. Although fuel prices have declined significantly since their record high in July 2008, the global financial instability and economic recession have put downward pressure on demand for air travel.

Traffic was down by 4.4% and 22.4% at Alaska and Horizon, respectively, in the fourth quarter as the economic recession began to take its toll on travel behaviors of our customers. In anticipation of this decline in demand, the Alaska and Horizon reduced capacity by 7.1% and 21.1%, respectively, in the fourth quarter. We currently anticipate further capacity

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reductions of 8% at Alaska and 9% at Horizon in 2009 compared with 2008. We believe the actions we are taking to reduce capacity are necessary and appropriate given the uncertainty in the demand outlook, although we do have the flexibility to adjust our capacity throughout the year to stay aligned with demand.

Oil prices have declined from a record $147 per barrel in July to approximately $40 to $45 per barrel recently. That translates to a significant reduction in fuel cost for Air Group, although prices are still above historical levels. In July 2008, our average raw, unhedged price of jet fuel per gallon was $4.19 and is currently around $1.60 per gallon. Oil prices continue to be volatile, however, and prices could rise again. We continue to execute our hedging strategy to help remove some of the impact of that volatility on our financial results.

RESULTS OF OPERATIONS

2008 COMPARED WITH 2007

Our consolidated net loss for 2008 was $135.9 million, or $3.74 per share, compared to net income of $124.3 million, or $3.07 per diluted share, in 2007. Both periods include gains and losses arising from fuel-hedging activities. In 2008, there were several other items, as noted below, that affect the comparability between the two years:

- restructuring charges of $12.9 million ($8.1 million after tax, or $0.22 per share) related to the reduction in work force at Alaska;
- fleet transition charges of $61.0 million ($38.2 million after tax, or $1.05 per share) related to the ongoing transitions out of the MD-80 and CRJ-700 fleets; and
- a $42.3 million benefit ($26.5 million after tax, or $0.73 per share) related to a change in the terms of our Mileage Plan program.

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

- it is useful to monitor performance without these items as it improves a reader s ability to compare our results to other airlines;
- our results excluding these adjustments related to fuel hedge accounting and other items serve as the basis for our various employee incentive plans, thus the information allows investors to better understand the changes in variable incentive pay expense in our consolidated statements of operations;
- our results excluding these items are most often used in internal management and board reporting and decision-making; and

we believe it is the basis by which we are evaluated by industry analysts.

Our consolidated results are primarily driven by the results of our two operating carriers. Alaska and Horizon reported pretax losses of $153.3 million and $55.8 million, respectively, in 2008. Financial and statistical data for Alaska and Horizon are shown on pages 34 and 35, respectively. An in-depth discussion of the results of Alaska and Horizon begins on page 36.

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ALASKA AIRLINES FINANCIAL AND STATISTICAL DATA

	Three Months Ended December 31			Year Ended December 31				
	2008	**2007**	**% Change**	**2008**	**2007**	**% Change**	**2006**	**% Change**
Financial Data (in millions):								
Operating Revenues:								
Passenger	**$ 602.5**	$ 612.8	(1.7)	**$ 2,643.7**	$ 2,547.2	3.8	$ 2,453.1	3.8
Freight and mail	**22.2**	21.3	4.2	**99.3**	94.2	5.4	93.4	0.9
Other net	**34.0**	41.3	(17.7)	**135.2**	147.1	(8.1)	129.6	13.5
Change in Mileage Plan terms			NM	**42.3**		NM		NM
Total mainline operating revenues	**658.7**	675.4	(2.5)	**2,920.5**	2,788.5	4.7	2,676.1	4.2
Passenger purchased capacity	**66.9**	71.9	(7.0)	**300.8**	281.4	6.9	16.4	NM
Total Operating Revenues	**725.6**	747.3	(2.9)	**3,221.3**	3,069.9	4.9	2,692.5	14.0
Operating Expenses:								
Wages and benefits	**183.8**	191.0	(3.8)	**742.7**	753.9	(1.5)	745.8	1.1
Variable incentive pay	**5.0**	2.3	117.4	**15.8**	13.5	17.0	27.7	(51.3)
Aircraft fuel, including hedging gains and losses	**298.4**	182.2	63.8	**1,162.4**	737.5	57.6	757.0	(2.6)
Aircraft maintenance	**38.5**	42.0	(8.3)	**150.6**	149.8	0.5	156.8	(4.5)
Aircraft rent	**23.8**	29.5	(19.3)	**106.2**	112.8	(5.9)	110.9	1.7
Landing fees and other rentals	**40.8**	42.8	(4.7)	**167.7**	170.1	(1.4)	158.2	7.5
Contracted services	**29.7**	32.9	(9.7)	**130.2**	124.1	4.9	117.5	5.6
Selling expenses	**20.4**	30.0	(32.0)	**116.0**	129.3	(10.3)	141.5	(8.6)
Depreciation and amortization	**42.7**	36.2	18.0	**165.9**	142.3	16.6	137.8	3.3
Food and beverage service	**11.2**	12.1	(7.4)	**48.3**	46.9	3.0	48.3	(2.9)
Other	**40.1**	48.1	(16.6)	**170.3**	173.1	(1.6)	161.1	7.4
Restructuring charges and adjustments	**9.2**		NM	**12.9**		NM	24.8	NM
Fleet transition costs MD-80			NM	**47.5**		NM	189.5	NM
Total mainline operating expenses	**743.6**	649.1	14.6	**3,036.5**	2,553.3	18.9	2,776.9	(8.1)
Purchased capacity costs	**66.9**	80.7	(17.1)	**313.7**	302.8	3.6	14.3	NM
Total Operating Expenses	**810.5**	729.8	11.1	**3,350.2**	2,856.1	17.3	2,791.2	2.3
Operating Income (Loss)	**(84.9)**	17.5	NM	**(128.9)**	213.8	NM	(98.7)	NM
Interest income	**13.1**	15.1		**51.3**	64.8		56.3	
Interest expense	**(25.0)**	(21.3)		**(92.5)**	(86.2)		(73.3)	
Interest capitalized	**4.1**	6.6		**20.2**	25.7		21.5	
Other net	**(0.7)**	(2.7)		**(3.4)**	(3.1)		(0.5)	
	(8.5)	(2.3)		**(24.4)**	1.2		4.0	
Income (Loss) Before Income Tax	**$ (93.4)**	$ 15.2	NM	**$ (153.3)**	$ 215.0	NM	$ (94.7)	NM
Mainline Operating Statistics:								
Revenue passengers (000)	**3,772**	4,191	(10.0)	**16,809**	17,558	(4.3)	17,165	2.3
RPMs (000,000) traffic	**4,302**	4,498	(4.4)	**18,712**	18,451	1.4	17,822	3.5
ASMs (000,000) capacity	**5,590**	6,020	(7.1)	**24,218**	24,208	0.0	23,278	4.0
Passenger load factor	**77.0%**	74.7%	2.3pts	**77.3%**	76.2%	1.1pts	76.6%	(0.4)pts
Yield per passenger mile	**14.01¢**	13.62¢	2.8	**14.13¢**	13.81¢	2.3	13.76¢	0.3
	11.78¢	11.22¢	5.0	**12.06¢**	11.52¢	4.7	11.50¢	0.2

Operating revenues per ASM								
RASM								
Impact of change in Mileage Plan terms per ASM			NM	**0.17¢**		NM		NM
Passenger revenue per ASM	**10.78¢**	10.18¢	5.9	**10.92¢**	10.52¢	3.7	10.54¢	(0.2)
Operating expenses per ASM	**13.30¢**	10.78¢	23.4	**12.54¢**	10.55¢	18.9	11.93¢	(11.6)
Aircraft fuel cost per ASM	**5.34¢**	3.02¢	76.4	**4.80¢**	3.05¢	57.4	3.25¢	(6.2)
Restructuring charges per ASM	**0.16¢**		NM	**0.05¢**		NM	0.11¢	NM
Fleet transition costs per ASM			NM	**0.20¢**		NM	0.81¢	NM
Aircraft fuel cost per gallon	**$ 3.95**	$ 2.09	89.0	**$ 3.48**	$ 2.08	67.3	$ 2.14	(2.8)
Economic fuel cost per gallon	**$ 2.52**	$ 2.48	1.6	**$ 3.00**	$ 2.20	36.4	$ 1.92	14.6
Fuel gallons (000,000)	**75.5**	87.2	(13.4)	**333.8**	354.3	(5.8)	354.3	0.0
Average number of full-time equivalent employees	**9,156**	9,672	(5.3)	**9,628**	9,679	(0.5)	9,322	3.8
Aircraft utilization (blk hrs/day)	**10.0**	10.7	(6.5)	**10.6**	10.9	(2.8)	11.0	(0.9)
Average aircraft stage length (miles)	**995**	946	5.2	**979**	926	5.7	919	0.8
Operating fleet at period-end	**110**	115	(5)a/c	**110**	115	(5)a/c	114	1a/c
Purchased Capacity Operating Statistics:								
RPMs (000,000)	**227**	287	(20.9)	**1,100**	1,099	0.1	41	NM
ASMs (000,000)	**316**	386	(18.1)	**1,469**	1,453	1.1	67	NM
Passenger load factor	**71.8%**	74.4%	(2.6)pts	**74.9%**	75.6%	(0.7)pts	61.2%	NM
Yield per passenger mile	**29.47¢**	25.05¢	17.6	**27.35¢**	25.61¢	6.8	40.00¢	NM
Operating revenue per ASM	**21.17¢**	18.63¢	13.7	**20.48¢**	19.37¢	5.7	24.48¢	NM
Operating expenses per ASM	**21.17¢**	20.91¢	1.3	**21.35¢**	20.84¢	2.5	21.34¢	NM

NM = Not Meaningful

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HORIZON AIR FINANCIAL AND STATISTICAL DATA

	Three Months Ended December 31			Year Ended December 31				
	2008	**2007**	**% Change**	**2008**	**2007**	**% Change**	**2006**	**% Change**
Financial Data (in millions):								
Operating Revenues:								
Passenger brand flying	**$ 98.5**	$ 99.2	(0.7)	**$ 429.2**	$ 391.3	9.7	$ 359.1	9.0
Passenger capacity purchase arrangements (a)	**62.5**	80.4	(22.3)	**293.7**	317.9	(7.6)	274.0	16.0
Total passenger revenue	**161.0**	179.6	(10.4)	**722.9**	709.2	1.9	633.1	12.0
Freight and mail	**0.6**	0.5	20.0	**2.7**	2.3	17.4	3.9	(41.0)
Other net	**2.1**	1.8	16.7	**8.3**	6.9	20.3	7.0	(1.4)
Total Operating Revenues	**163.7**	181.9	(10.0)	**733.9**	718.4	2.2	644.0	11.6
Operating Expenses:								
Wages and benefits	**46.9**	51.1	(8.2)	**194.1**	201.3	(3.6)	189.7	6.1
Variable incentive pay	**1.4**	1.3	7.7	**5.6**	7.3	(23.3)	9.1	(19.8)
Aircraft fuel, including hedging gains and losses	**60.4**	38.3	57.7	**236.0**	138.8	70.0	116.5	19.1
Aircraft maintenance	**10.7**	23.1	(53.7)	**58.2**	92.0	(36.7)	73.9	24.5
Aircraft rent	**13.2**	15.7	(15.9)	**56.9**	65.6	(13.3)	69.3	(5.3)
Landing fees and other rentals	**13.6**	14.1	(3.5)	**57.2**	56.9	0.5	46.9	21.3
Contracted services	**7.1**	7.2	(1.4)	**29.1**	27.1	7.4	27.0	0.4
Selling expenses	**6.4**	7.7	(16.9)	**31.1**	31.2	(0.3)	31.5	(1.0)
Depreciation and amortization	**8.7**	8.6	1.2	**37.5**	33.9	10.6	18.5	83.2
Food and beverage service	**0.5**	0.7	(28.6)	**2.6**	2.8	(7.1)	2.9	(3.4)
Other	**9.0**	12.3	(26.8)	**42.7**	48.0	(11.0)	46.9	2.3
Fleet transition costs CRJ-700	**6.7**		NM	**13.5**		NM		NM
Fleet transition costs Q200	**0.5**	3.5	NM	**10.2**	14.1	NM		NM
Total Operating Expenses	**185.1**	183.6	0.8	**774.7**	719.0	7.7	632.2	13.7
Operating Income (Loss)	**(21.4)**	(1.7)	NM	**(40.8)**	(0.6)	NM	11.8	NM
Interest income	**1.6**	1.1		**5.4**	4.5		3.7	
Interest expense	**(6.7)**	(4.5)		**(23.6)**	(16.6)		(7.4)	
Interest capitalized	**0.7**	0.3		**3.0**	2.1		3.2	
Other net	**0.1**			**0.2**	(0.1)			
	(4.3)	(3.1)		**(15.0)**	(10.1)		(0.5)	
Income (Loss) Before Income Tax	**$ (25.7)**	$ (4.8)	NM	**$ (55.8)**	$ (10.7)	NM	$ 11.3	NM
Combined Operating Statistics: (a)								
Revenue passengers (000)	**1,636**	1,930	(15.2)	**7,390**	7,552	(2.1)	6,860	10.1
RPMs (000,000) traffic	**561**	723	(22.4)	**2,635**	2,918	(9.7)	2,691	8.4
ASMs (000,000) capacity	**786**	996	(21.1)	**3,617**	3,978	(9.1)	3,632	9.5
Passenger load factor	**71.4%**	72.6%	(1.2)pts	**72.9%**	73.4%	(0.5)pts	74.1%	(0.7)pts
Yield per passenger mile	**28.70¢**	24.84¢	15.5	**27.43¢**	24.30¢	12.9	23.53¢	3.3
Operating revenues per ASM (RASM)	**20.83¢**	18.26¢	14.0	**20.29¢**	18.06¢	12.4	17.73¢	1.9
Passenger revenue per ASM	**20.48¢**	18.03¢	13.6	**19.99¢**	17.83¢	12.1	17.43¢	2.3
Operating expenses per ASM	**23.55¢**	18.43¢	27.8	**21.42¢**	18.07¢	18.5	17.41¢	3.8
Aircraft fuel cost per ASM	**7.69¢**	3.85¢	99.6	**6.53¢**	3.49¢	87.1	3.21¢	8.7
	0.85¢		NM	**0.37¢**		NM		NM

CRJ-700 fleet transition costs per ASM								
Q200 fleet transition costs per ASM	**0.06¢**	0.35¢	NM	**0.28¢**	0.35¢	NM		NM
Aircraft fuel cost per gallon	**$ 4.08**	$ 2.18	87.2	**$ 3.53**	$ 2.14	65.0	$ 2.14	0.0
Economic fuel cost per gallon	**$ 2.58**	$ 2.54	1.6	**$ 3.05**	$ 2.28	33.8	$ 1.93	18.1
Fuel gallons (000,000)	**14.8**	17.6	(15.9)	**66.9**	64.8	3.2	54.3	19.3
Average number of full-time equivalent employees	**3,466**	3,941	(12.1)	**3,699**	3,897	(5.1)	3,611	7.9
Aircraft utilization (blk hrs/day)	**8.0**	8.4	(4.8)	**8.3**	8.6	(3.5)	8.8	(2.3)
Average aircraft stage length (miles)	**312**	356	(12.4)	**334**	351	(4.8)	331	6.0
Operating fleet at period-end	**59**	70	(11)a/c	**59**	70	(11)a/c	69	1a/c

NM = Not Meaningful

(a) Represents combined information for Horizon flights operated under Capacity Purchase Agreements (CPAs) with Alaska and as Frontier Jet Express (through November 2007). See page 42 for additional line of business information.

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ALASKA AIRLINES

Alaska reported a loss before income taxes of $153.3 million during 2008 compared to income before income taxes of $215.0 million in 2007. The $368.3 million difference between the periods is primarily due to the $424.9 million increase in aircraft fuel expense (including hedging gains and losses) compared to the prior period, $47.5 million of fleet transition costs, and $12.9 million of restructuring charges partially offset by a $151.4 million increase in operating revenues.

ALASKA REVENUES

Total operating revenues increased $151.4 million, or 4.9%, in 2008 as compared to 2007. The components of Alaska s revenue are summarized in the following table:

	Years Ended December 31		
(in millions)	**2008**	**2007**	**% Change**
Passenger revenue mainline	**$ 2,643.7**	$ 2,547.2	3.8
Freight and mail	**99.3**	94.2	5.4
Other net	**135.2**	147.1	(8.1)
Change in Mileage Plan terms	**42.3**		NM
Total mainline operating revenues	**$ 2,920.5**	$ 2,788.5	4.7
Passenger revenue purchased capacity	**300.8**	281.4	6.9
Total operating revenues	**$ 3,221.3**	$ 3,069.9	4.9

NM = Not Meaningful

Operating Revenue Mainline

Mainline passenger revenue for the full year increased 3.8% on flat capacity and a 3.7% increase in passenger revenues per available seat mile (PRASM). The increase in mainline PRASM was the result of a 2.3% increase in yields and a 1.1-point increase in load factor compared to the prior-year period. An increase in Mileage Plan redemption revenue and higher ancillary fee revenue contributed significantly to the increase in yields compared to 2007. Although capacity and traffic were relatively flat, traffic declined in the third and fourth quarters as the economic recession deepened. In response, we reduced capacity, with the most significant reductions taking place in the fourth quarter.

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Our advance bookings currently suggest that load factors will be relatively flat in the first quarter of 2009 compared to the same period in 2008, although that is with a 10% to 11% decline in capacity.

Freight and mail revenues increased $5.1 million, or 5.4%, over 2007. The increase is due to increased yields for freight and mail and freight fuel surcharges, partially offset by a decline in freight volumes compared to the prior year. As fuel prices decline, fuel surcharge revenue is also expected to decline in 2009.

Other net revenues declined $11.9 million, or 8.1%, primarily as a result of lower commission revenue on the sale of Mileage Plan miles to our non-airline partners. We anticipate lower sales of miles to our affinity card partner in 2009 as general consumer credit card spending declines due to the economic recession.

Change in Mileage Plan Terms

Beginning in August 2008, we reduced the length of time that a Mileage Plan account could be inactive from three years to two years before the account is deleted. As a result of this change in terms, our Mileage Plan liability was reduced by $42.3 million. This benefit is recorded separately in operating revenues as Change in Mileage Plan terms.

Passenger Revenue Purchased Capacity

Passenger revenue purchased capacity increased by $19.4 million over the same period in 2007 because of a 5.7% increase in unit revenues on relatively flat capacity. Unit revenues have increased due to a 6.8% increase in yields, offset by a 0.7-point decline in load factors compared to 2007.

ALASKA EXPENSES

For the year, total operating expenses increased $494.1 million, or 17.3%, compared to 2007 as a result of higher mainline operating costs, most notably aircraft fuel expense (including hedging gains and losses), fleet transition charges and restructuring charges. We believe it is useful to summarize operating expenses as follows, which is consistent with the way expenses are reported internally and evaluated by management.

	Years Ended December 31		
Operating Expenses (in millions)	**2008**	**2007**	**% Change**
Mainline operating expenses	**$ 3,036.5**	$ 2,553.3	18.9
Purchased capacity costs	**313.7**	302.8	3.6
Total Operating Expenses	**$ 3,350.2**	$ 2,856.1	17.3

Mainline Operating Expenses

Significant mainline operating expense variances are described below.

Along with our financial and statistical data on page 34, we are presenting here our line-item expenses on a per-ASM basis (in cents). We believe this information is useful to investors because it highlights areas in which costs have increased or decreased either more or less than capacity:

	Years Ended December 31,			CASM Change	
	2008	**2007**	**2006**	**2008 vs. 2007**	**2007 vs. 2006**
Wages and benefits	**3.06**	3.11	3.20	(0.05)	(0.09)
Variable incentive pay	**0.07**	0.06	0.12	0.01	(0.06)
Aircraft fuel, including hedging gains and losses	**4.80**	3.05	3.25	1.75	(0.20)
Aircraft maintenance	**0.62**	0.62	0.67		(0.05)
Aircraft rent	**0.44**	0.47	0.48	(0.03)	(0.01)
Landing fees and other rentals	**0.69**	0.70	0.68	(0.01)	0.02
Contracted services	**0.54**	0.51	0.50	0.03	0.01
Selling expenses	**0.48**	0.53	0.61	(0.05)	(0.08)
Depreciation and amortization	**0.69**	0.59	0.59	0.10	
Food and beverage service	**0.20**	0.19	0.21	0.01	(0.02)
Other	**0.70**	0.72	0.70	(0.02)	0.02
Restructuring charges and adjustments	**0.05**		0.11	0.05	(0.11)
Fleet transition charges	**0.20**		0.81	0.20	(0.81)
Total Mainline Operating Expenses per ASM	**12.54**	10.55	11.93	1.99	(1.38)

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Additional line item information is provided below.

Wages and Benefits

Wages and benefits decreased during the full year of 2008 by $11.2 million, or 1.5%, primarily as a result of lower defined-benefit pension costs, overtime, and a 0.5% decrease in full-time equivalent employees compared to 2007.

We currently expect wages and benefits to be flat in 2009 but to increase on a per-ASM basis. Although we expect a significant decline in full-time equivalent employees resulting from the recent reduction in work force, our defined-benefit pension costs are increasing substantially from $48 million in 2008 to an estimated $93 million next year because of poor market returns in 2008. This expectation is exclusive of any potential change in pilot wages that may result from our current contract negotiations.

Variable Incentive Pay

Variable incentive pay for 2008 increased $2.3 million or 17.0%, compared to 2007. The increase is primarily due to higher payouts under our Operational Performance Reward program, offset by lower overall payouts in our profit-sharing plans due to the decline in profitability from 2007. For our incentive pay plans, profit is generally defined as results excluding fleet transition costs, restructuring charges, and other amounts specified in the various incentive plan documents and with fuel stated on an economic basis. Air Group maintains several incentive plans that collectively cover all of our employees and create alignment for employees, customers and shareholders. These plans include both operational and financial performance metrics that, to a large extent, are based on certain annual financial targets.

Aircraft Fuel

Aircraft fuel expense includes both *raw fuel expense* (as defined below) plus the effect of mark-to-market adjustments to our portfolio of hedges included in our income statement as the value of that portfolio increases and decreases. Our aircraft fuel expense is very volatile, even between quarters, because it includes these gains or losses in the value of the underlying instruments as crude oil prices 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 increased $424.9 million, or 57.6%, compared to 2007. The elements of the change are illustrated in the following table:

	Years Ended December 31		
(in millions, except	**2008**	**2007**	**% Change**

per-gallon amounts)			
Fuel gallons consumed	**333.8**	354.3	(5.8)
Raw price per gallon	**$ 3.31**	$ 2.33	42.1
Total raw fuel expense	**$ 1,103.8**	$ 825.7	33.7
Net impact on fuel expense from (gains) and losses arising from fuel-hedging activities	**58.6**	(88.2)	NM
Aircraft fuel expense	**$ 1,162.4**	$ 737.5	57.6

NM = Not meaningful

Fuel gallons consumed decreased 5.8% due to the decrease in capacity and the improved fuel efficiency of our fleet as we completed the fleet transition out of the less-efficient MD-80 aircraft to newer, more-efficient B737-800 aircraft on relatively flat capacity for the year. Because the B737-800 aircraft are larger than the MD-80s, the flat capacity came on a 2.6% decline in revenue block hours.

The raw fuel price per gallon increased by 42.1% as a result of higher West Coast jet fuel prices driven by higher crude oil costs for much of the year. Crude oil prices have declined dramatically since the record high set in July 2008. Based on the current price of jet fuel, we expect that the raw fuel price per gallon in the first quarter of 2009 will be significantly lower than in the same period of 2008.

During 2008, we recorded significant mark-to-market losses reflecting a steep decline in the value of our fuel hedge portfolio as fuel

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prices declined sharply late in the year. During 2007, we recorded mark-to-market gains reflecting an increase in the value of our fuel hedge portfolio between December 31, 2006 and December 31, 2007. Our hedge portfolio consists primarily of call options that are based on the price of crude oil.

We also evaluate *economic fuel expense*, which we define as *raw fuel expense* less the cash we receive from hedge counterparties for hedges that settle during the period under their original contract expiration terms, offset by 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 only when they are realized through a cash receipt from our hedge contract counterparties for those contracts that were settled during the period based on their original contract settlement terms. We believe this is the best measure of the effect that fuel prices are currently having on our business because it most closely approximates the net cash outflow associated with purchasing fuel for our operations. Accordingly, many industry analysts evaluate our results using this measure, and it is the basis for most internal management reporting and incentive pay plans.

Our *economic fuel expense* is calculated as follows:

(in millions, except per-gallon amounts)	Years Ended December 31 2008	2007	% Change
Raw fuel expense	**$ 1,103.8**	$ 825.7	33.7
Less: cash received from settled hedges, net of premium expense recognized	**(101.8)**	(44.9)	NM
Economic fuel expense	**$ 1,002.0**	$ 780.8	28.3
Fuel gallons consumed	**333.8**	354.3	(5.8)
Economic fuel cost per gallon	**$ 3.00**	$ 2.20	36.4

NM = Not meaningful

The total net cash benefit from hedges that settled during 2008, excluding hedges that were terminated early, increased by $56.9 million to $101.8 million compared to 2007. This increase was primarily due to the record high crude oil prices during the year.

As part of our effort to restructure our fuel-hedge portfolio as noted earlier, we terminated a number of contracts originally scheduled to settle in 2009 and 2010 and replaced them with new positions having lower average strike prices. As a result, we realized losses of approximately $41.5 million, representing the difference between the original premiums paid for those contracts when purchased and the amount of cash received from the counterparty on termination of the contracts. We do not anticipate further restructuring of the portfolio at this time. Based on current jet fuel prices, we expect our *economic fuel expense* to be lower in 2009 than in 2008 because of lower crude oil prices.

Aircraft Rent

Aircraft rent declined by $6.6 million, or 5.9% during 2008, because of the retirement of all remaining leased MD-80 aircraft, offset by one additional leased B737-800 aircraft since 2007. We expect aircraft rent will be flat to slightly higher in 2009 as the elimination of the MD-80 rent is offset by lease expense on B737-800 aircraft as we plan to finance six aircraft with sale-leaseback transactions.

Landing Fees and Other Rents

Landing fees and other rents declined by $2.4 million, or 1.4%, compared to 2007. The decline is primarily attributable to the decline in departures resulting in lower landing fees across the system. However, looking forward into 2009, even though we are expecting capacity and departure declines, airport costs may not decline ratably. Airport costs are generally spread across the airlines based on passenger counts and departures. As the industry cuts capacity, airport costs on a per-passenger or per-departure basis will likely increase.

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Contracted Services

During 2008, contracted services increased by $6.1 million, or 4.9%, compared to 2007. This is primarily due to efforts to improve our operational performance and the introduction of new stations in our route system where we contract airport services. We expect contracted services to decline approximately 5% in 2009 as we decrease our departures across the system and require less handling at airports.

Selling Expenses

Selling expenses declined $13.3 million, or 10.3%, compared to 2007. The decline is driven by lower ticket distribution fees and lower expenses associated with our Mileage Plan program. We expect selling expenses to increase slightly in 2009 primarily driven by increases in our advertising and marketing efforts tied to our initiative to increase unit revenues.

Depreciation and Amortization

Depreciation and amortization increased $23.6 million, or 16.6%, compared to 2007 as a result of the delivery of 11 B737-800 aircraft delivered in 2008. We expect depreciation and amortization to be about flat in 2009. Although we took delivery of 11 new aircraft in 2008 and expect ten more in 2009, we expect to sell up to four B737-700 aircraft and complete sale-leaseback transactions for six B737-800s.

Other Operating Expenses

Other operating expenses increased primarily because of higher personnel and crew costs, property taxes, and legal fees, partially offset by a decline in passenger remuneration costs stemming from our improved operational performance.

Restructuring Charges and Fleet Transition Costs

In the third quarter of 2008, we announced reductions in work force among union and non-union employees. The non-union employees that were affected by the reduction were terminated in the third quarter, resulting in a $1.6 million severance charge. For union personnel, we offered extended leaves, a voluntary furlough program, and an early-out package with a lump-sum payment based on years of service that included continuation of medical coverage and travel privileges for a specified period. In addition to the voluntary offers, there have been involuntary furloughs to achieve the target reduction in work force. We recorded an $11.3 million charge in 2008 representing the severance payments and estimated medical coverage obligation for the affected union employees.

During 2008, we retired four MD-80 aircraft that were under long-term lease arrangements and placed them in temporary storage at an aircraft storage facility. The $47.5 million charge in the period represents the remaining lease payments under the lease contract and our estimate of maintenance costs that will be incurred in the future to meet the minimum return conditions under the lease requirements.

Mainline Operating Costs per Available Seat Mile (CASM)

Operating costs per ASM (CASM) is an important metric in the industry, and we use it to gauge the effectiveness of our cost-reduction efforts. Our effort to reduce unit costs focuses not only on controlling the actual dollars we spend, but also on increasing our capacity without adding a commensurate amount of cost.

Our mainline operating costs per mainline ASM are summarized below:

	Years Ended December 31		
	2008	**2007**	**% Change**
Total mainline operating expenses per ASM (CASM)	**12.54¢**	10.55¢	18.9
CASM includes the following components:			
Aircraft fuel costs per ASM	**4.80¢**	3.05¢	57.4
Restructuring costs per ASM	**0.05¢**		NM
Fleet transition charges per ASM	**0.20¢**		NM

NM = Not meaningful

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

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

Mainline cost per ASM excluding fuel and certain special items is one of the most important measures used by managements of both Alaska and Horizon and by the Air Group Board of Directors in assessing quarterly and annual cost performance. For Alaska Airlines, these decision-makers evaluate operating results of the mainline operation, which includes the operation of the B737 fleet branded in Alaska Airlines livery. The revenues and expenses associated with purchased capacity are evaluated separately.

Mainline cost per ASM excluding fuel, fleet transition charges and restructuring charges (and other items as specified in our plan documents) is an important metric for the employee incentive plan that covers company management and executives.

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

Disclosure of the individual impact of certain noted items provides investors the ability to measure and monitor performance both with and without these special items. We believe that disclosing the impact of certain items, such as fleet transition costs and restructuring charges, 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 mainline passenger unit revenues for Alaska, we do not (nor are we able to) evaluate mainline unit revenues excluding the impact that rising fuel costs have had on ticket prices. Economic fuel cost represents approximately 35% of our total mainline operating expenses, excluding fleet transition and restructuring charges and with fuel stated on an economic basis. Fluctuations in our 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.

We currently forecast our mainline costs per ASM excluding fuel for the first quarter and the full year of 2009 to be up 11% to 12% and up 7% to 8%, respectively, compared to 2008. The increase in unit costs on a full-year basis is primarily due to the following:

Expected capacity reductions of 8% for 2009;

A $45 million increase in defined-benefit pension costs from $48 million in 2008 to an estimated $93 million in 2009;

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An increase of $10 million in maintenance expense due to the timing of planned maintenance events and the start of a power-by-the-hour agreement on our B737-700 and B737-900 aircraft, which is expected to provide cost savings over the life of the agreement, but will result in higher expense in 2009;

Approximately $10 million in additional aircraft rent that would have been reported as interest expense because of our decision to complete sale-leaseback transactions on six B737-800 aircraft; and

An approximate $15 million increase in our expected incentive payouts in 2009 compared to 2008. Our current expectation is that our results will be better in 2009 compared to those in 2008. However, actual results can differ significantly as the revenue environment is uncertain and fuel is volatile.

Purchased Capacity Costs

Purchased capacity costs increased $10.9 million to $313.7 million during 2008 compared to $302.8 million in 2007. Of the total, $293.7 million was paid to Horizon under the capacity purchase arrangement (CPA) for 1.4 billion ASMs. This expense is eliminated in consolidation.

HORIZON AIR

Horizon reported a loss before income taxes of $55.8 million during 2008 compared to $10.7 million in 2007. The $45.1 million decline in profitability is primarily due to higher fuel costs and fleet transition costs, partially offset by lower non-fuel operating costs and higher operating revenues.

HORIZON REVENUES

In 2008, operating revenues increased $15.5 million, or 2.2%, compared to 2007. Horizon s passenger revenues are summarized in the table below:

Revenues (in millions) and % of ASMs	Years Ended December 31 2008		2007	
	Revenues	**% ASMs**	**Revenues**	**% ASMs**
Passenger revenue from Horizon brand flying	**$ 429.2**	**61**	$ 391.3	52
Revenue from CPA with Alaska	**293.7**	**39**	283.4	35
Revenue from CPA with Frontier JetExpress			34.5	13
Total passenger revenue and % of ASMs	**$ 722.9**	**100%**	$ 709.2	100%

Line-of-business information is presented in the table below. In the CPAs, Horizon is insulated from market revenue factors and is guaranteed contractual revenue amounts based on operational capacity. As a result, yield and load factor information for the CPA arrangements are not presented.

	Year Ended December 31, 2008									
	Capacity and Mix			Load Factor		Yield		RASM		
	2008 Actual (000,000)	2007 Actual (000,000)	Change Y-O-Y	Actual	Point Change Y-O-Y	Actual	Change Y-O-Y	2008 Actual	2007 Actual	Change Y-O-Y
Brand Flying	**2,221**	2,086	6.5%	**71.1%**	(0.7)	**27.20¢**	4.1%	**19.82¢**	19.20¢	3.2%
Alaska CPA	**1,396**	1,383	0.9%	**NM**	NM	**NM**	NM	**21.04¢**	20.49¢	2.7%
Frontier CPA		509	(100.0)%	**NM**	NM	**NM**	NM	**NM**	6.77¢	NM
System Total	**3,617**	3,978	(9.1)%	**72.9%**	(0.5)	**27.43¢**	12.9%	**20.29¢**	18.06¢	12.4%

NM = Not meaningful

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System-wide, Horizon s operating unit revenues increased 12.4% compared to 2007. However, the increase was largely due to the shift in capacity out of Frontier JetExpress flying (which produced relatively low RASM because of the nature of the contract) to higher RASM brand and Alaska CPA flying. As mentioned earlier, the Frontier JetExpress operation ceased in November 2007.

Horizon brand flying includes routes in the Horizon system not covered by the Alaska CPA. Horizon has the inventory and revenue risk in these markets. Passenger revenue from Horizon brand flying increased $37.9 million, or 9.7%, on a 6.5% increase in brand capacity and a 3.2% increase in unit revenues. The increase in unit revenues was due to a 4.1% increase in yields in those markets, partially offset by a 0.7-point decline in load factor.

Revenue from the CPA with Alaska totaled $293.7 million during 2008 compared to $283.4 million in 2007. The increase is primarily driven by the 2.7% increase in unit revenues on relatively flat capacity. Under the CPA, the fee paid by Alaska is based on Horizon s operating costs plus a specified margin. This revenue is eliminated in consolidation.

HORIZON EXPENSES

Total operating expenses increased $55.7 million, or 7.7%, as compared to 2007. Along with our financial and statistical data on page 35, we are presenting here our line item expenses on a per-ASM basis (in cents):

	Years Ended December 31,			CASM Change	
	2008	**2007**	**2006**	**2008 vs. 2007**	**2007 vs. 2006**
Wages and benefits	**5.37**	5.06	5.22	0.31	(0.16)
Variable incentive pay	**0.15**	0.18	0.25	(0.03)	(0.07)
Aircraft fuel, including hedging gains and losses	**6.53**	3.49			