

Alaska Air Group, Inc. (ALK)

\$66.89 (As of 01/29/20)

Price Target (6-12 Months): **\$71.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/15/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

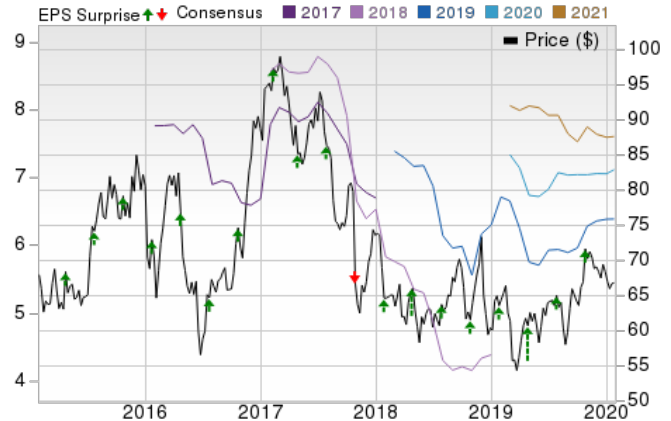
Growth: B

Momentum: B

Summary

Alaska Air Group has been benefiting from upbeat passenger revenues (increased 6% in 2019). The company's performance with respect to unit revenues is also encouraging. For the first quarter of 2020, the carrier anticipates total unit revenues to rise year over year in the 0.5-3.5% range. The airline's measures to add shareholder value also hold promise. To this end, the company raised its quarterly dividend by 7.1% in January this year. Strong free cash-flow generation should lead to a further uptick in such measures. Its debt reduction efforts further add to the positivity. Due to these tailwinds, shares of the company have outperformed its industry in a year. However, high non-fuel unit costs, which are affecting its bottom-line growth. Such costs, which grew 2.3% in 2019, are expected to rise roughly 2% in the March-end quarter.

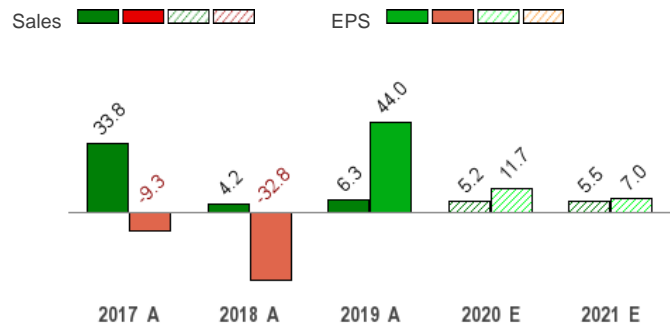
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$72.22 - \$53.39
20 Day Average Volume (sh)	1,253,765
Market Cap	\$8.2 B
YTD Price Change	-1.3%
Beta	0.78
Dividend / Div Yld	\$1.40 / 2.1%
Industry	Transportation - Airline
Zacks Industry Rank	Top 13% (34 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.6%
Last Sales Surprise	0.3%
EPS F1 Est- 4 week change	1.7%
Expected Report Date	04/23/2020
Earnings ESP	2.0%
P/E TTM	10.4
P/E F1	9.3
PEG F1	0.5
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,075 E	2,497 E	2,576 E	2,398 E	9,747 E
2020	1,991 E	2,405 E	2,452 E	2,283 E	9,241 E
2019	1,876 A	2,288 A	2,389 A	2,228 A	8,781 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.37 E	\$2.77 E	\$2.82 E	\$1.80 E	\$7.67 E
2020	\$0.42 E	\$2.54 E	\$2.70 E	\$1.62 E	\$7.17 E
2019	\$0.17 A	\$2.17 A	\$2.63 A	\$1.46 A	\$6.42 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/29/2020. The reports text is as of 01/30/2020.

Overview

Alaska Air Group, together with its partner regional carriers, serves more than 100 cities across North America. The carrier's mainline operating fleet includes multiple B737 and Airbus A320 family jets. Its regional operations include flights operated by Horizon Air, which was acquired in 1986, SkyWest and PenAir. The carrier's mainline and regional fleet strength at the end of 2018 was 233 and 97 respectively. The carrier serves 115 destinations.

Horizon Air, which serves nearly 7 million passengers annually, sells its entire capacity to Alaska Airlines under a capacity purchase arrangement. Alaska Airlines was founded in 1932. The regional fleet operated by SkyWest had 32 E175 planes at the end of 2018.

Alaska Air Group, through its mainline operations, covers western United States, Canada and Mexico. It also offers passenger and cargo services to/within Alaska.

Furthermore, the company operates on long-haul east/west routes to Hawaii and multiple cities in the mid-continental and eastern United States, primarily from Seattle.

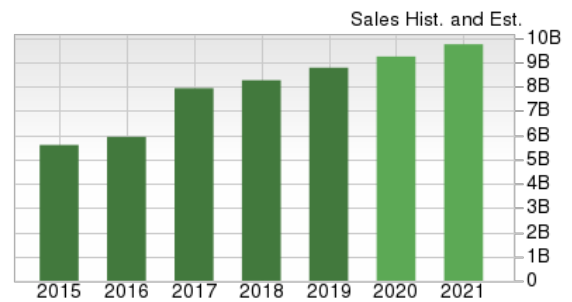
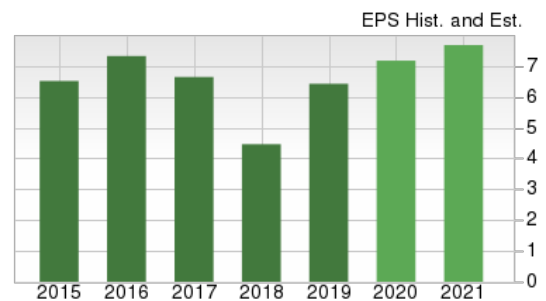
Along with a strong fleet of passenger jets (mainline), the company boasts contracts with Horizon, SkyWest Airlines and Peninsula Airways, that are responsible for the company's regional operations. The company's objective of entering into such contracts is to receive the entire passenger revenue from such operations.

The bulk of the company's revenue is generated through passenger operations. In 2018, passenger revenues contributed 92.4% (of which 84.8% came from mainline operations) to the company's top line of \$8,264 million. Mileage Plan and cargo and other revenues contributed 5.2% and 2.4% respectively to the company's top line in 2018.

Through its frequent flier partnerships, Alaska Air Group offers mileage credits and redemptions for members of its Mileage Plan scheme. Apart from frequent flier partnerships, the carrier also has codeshare and Interline agreements with other carriers.

Such customer-friendly arrangements boost the top line of Alaska Air Group. The acquisition of Virgin America, completed in Dec 2016, has significantly expanded Alaska Air Group's presence.

Alaska Air Group is based in Seattle, WA. The company's fiscal year coincides with the calendar year.



Reasons To Buy:

- ▲ Alaska Air Group is being aided by upbeat passenger revenues, which account for the bulk of the top line. Passenger revenues, which grew 8% in fourth-quarter 2019, are expected to rise in 2020 as well, courtesy of strong demand for air travel. Furthermore, the company's unit revenue outlook for the first quarter looks promising. On another positive note, fuel costs are expected to decline significantly to \$2.21 in the current quarter. As fuel expenses comprise a major chunk of airline expenditure, a decline in costs is likely to boost earnings in the quarter.
- ▲ We are impressed by the company's efforts to reward shareholders through dividends and buybacks. In January 2020, the company announced a 7.1% hike in quarterly dividend to 37.5 cents per share from 35 cents. The company is also active on the buyback front. The carrier repurchased 1,192,820 shares worth roughly \$75 million in 2019. Solid free cash-flow generation should lead to a further uptick in such shareholder-friendly activities. Notably, the company's free cash flow improved \$750 million year over year to \$1.1 billion in 2019.
- ▲ The airline's measures to reduce its debt levels are also encouraging. The carrier exited 2019 with long-term debt of \$1,264 million compared with \$1,617 million at the end of 2018. Additionally, debt-to-capitalization ratio was 41% compared with 47% in December 2018. During 2019, the company paid off more than \$600 million of its debt.
- ▲ The ratification of two five-year agreements with 5,200 airline staffs (clerical, office and passenger service employees as well as ramp service employees and store agents), represented by the International Association of Machinists and Aerospace Workers, is a positive for the company. The labor deals will provide employees with wage hikes, work security and retirement enhancements among other benefits. Alaska Air Group's efforts to expand its presence along the West Coast also raise optimism in the stock.

Impressive growth in passenger revenues is encouraging.

Reasons To Sell:

- ▼ Escalating non-fuel unit costs, mainly due to high labor costs, are limiting bottom-line growth. Evidently, non-fuel unit costs (excluding special items), which grew 2.3% in 2019, are expected to rise roughly 2% in the March-end quarter. The rising costs pose a threat to the company's bottom line.
- ▼ Additionally, Alaska Air Group is likely to see higher costs from Airbus lease returns in 2020 as well as in 2021. While the company has one return scheduled for 2020, it has nine scheduled for 2021. Moreover, even though the company's load factor has been improving lately owing to high traffic growth, we are wary of woes related to capacity overexpansion, given the moderate fuel price scenario. The company expects capacity for 2020 to increase between 3% and 4% from 2019 levels.
- ▼ The carrier's return on equity (ROE) of 19.6% compares unfavorably with the industry's 25.2%. The reading for the S&P 500 Index, of which Alaska Air Group is a member, is also higher at 20.6%. These unfavorable readings undercut the company's growth potential.

Rising non-fuel unit costs are hurting the company's growth prospects.

Last Earnings Report

Alaska Air Group Beats on Q4 Earnings

Alaska Air Group's earnings per share of \$1.46 beat the Zacks Consensus Estimate by 5 cents. Moreover, the bottom line surged 94.7% year over year on low fuel costs.

Revenues came in at \$2,228 million, surpassing the Zacks Consensus Estimate of \$2,220.5 million. The top line also increased approximately 8% year over year. Passenger revenues — contributing 92.3% to the top line — were up 8% on a year-over-year basis.

Quarter Ending **12/2019**

Report Date	Jan 28, 2020
Sales Surprise	0.34%
EPS Surprise	3.55%
Quarterly EPS	1.46
Annual EPS (TTM)	6.43

Operating Statistics

Consolidated traffic, measured in revenue passenger miles, rose 3.9% year over year in the reported quarter. Capacity (measured in available seat miles) expanded 3.5%. Load factor (percentage of seats occupied by passengers) improved 40 basis points to 83.7% as traffic growth outpaced capacity expansion in the reported quarter.

Total revenue per available seat mile (RASM: a key measure of unit revenues) increased 4.2% year over year to 13.38 cents in the quarter under discussion. Meanwhile, yield climbed 3.7% to 14.77 cents.

Operating Expenses & Income

In the fourth quarter, total operating expenses (on a reported basis) were down 2% year over year to \$1,976 million with expenses on aircraft fuel (including hedging gains and losses) declining 13%. Fuel price (economic) was \$2.21 per gallon, down 6% year over year.

Expenses on wages and benefits, however, flared up 14% in the December-end quarter. Operating income increased in excess of 100% from the prior-year quarter's level to \$252 million. Consolidated cost per available seat mile — excluding fuel and special items — inched up 0.7% to 9.01 cents.

Liquidity & Buybacks

At the end of 2019, the company had \$ 1,521 million in cash and marketable securities compared with \$1,236 million at the end of 2018.

Alaska Air exited the year with long-term debt of \$1,264 million compared with \$1,617 million at the end of 2018. Adjusted debt-to-capitalization ratio was 41% compared with 47% in December 2018. The carrier repurchased 1,192,820 shares worth roughly \$75 million in 2019.

Q1 Outlook

The company envisions capacity to rise approximately 4% year over year in the first quarter of 2020. Additionally, non-fuel unit costs (excluding special items) are projected to be up approximately 3% for the March-end quarter. RASM is projected to increase in the 0.5-3.5% band. Meanwhile, economic fuel cost is projected at \$2.21.

2020 Outlook

The company expects capacity for the full year to increase between 3% and 4% from 2019 levels. Non-fuel unit costs (excluding special items) are expected to rise roughly 2%. Meanwhile, capital expenditures are currently anticipated to be approximately \$750 million in the current year

Recent News

Dividend Increased – Jan 28, 2020

The company announced a 7.1% hike in quarterly dividend to 37.5 cents per share (annualized \$3). The first installment of the new dividend will be paid on March 5, to shareholders of record as of Feb 18, 2020. The latest increase marks the seventh such instance since the carrier started paying dividends in July 2013.

Valuation

Alaska Air Group shares are up 3.5% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 0.5% while those in the Zacks Transportation sector are up 6.2% over the past year. The S&P 500 index is up 21.3% over the past year.

The stock is currently trading at 9.36X trailing 12-month price to earnings, which compares to 8.47X for the Zacks sub-industry, 13.13X for the Zacks sector and 18.81X for the S&P 500 index.

Over the past 5 years, the stock has traded at a high of 14.04X and as low as 7.47X, with a 5-year median of 10.38X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$71 price target reflects 9.93X forward 12-month earnings.

The table below shows summary valuation data for ALK

Valuation Multiples - ALK					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.36	8.47	13.13	18.81
	5-Year High	14.04	12.3	17	19.34
	5-Year Low	7.47	6.85	10.48	15.18
	5-Year Median	10.38	9.04	13.16	17.45
EV/EBITDA TTM	Current	5.2	6.65	7.96	12.25
	5-Year High	6.96	7.22	11.08	12.86
	5-Year Low	4.43	4.32	6	8.48
	5-Year Median	5.52	6.05	7.43	10.68
P/S F12M	Current	0.25	0.7	1.13	3.49
	5-Year High	0.9	0.98	1.44	3.49
	5-Year Low	0.23	0.63	1.02	2.54
	5-Year Median	0.52	0.78	1.24	3

As of 01/29/2020

Industry Analysis Zacks Industry Rank: Top 13% (34 out of 255)



Top Peers

Delta Air Lines, Inc. (DAL)	Outperform
American Airlines Group Inc. (AAL)	Neutral
Allegiant Travel Company (ALGT)	Neutral
Hawaiian Holdings, Inc. (HA)	Neutral
JetBlue Airways Corporation (JBLU)	Neutral
Southwest Airlines Co. (LUV)	Neutral
Ryanair Holdings PLC (RYAAY)	Neutral
Spirit Airlines, Inc. (SAVE)	Neutral

Industry Comparison Industry: Transportation - Airline				Industry Peers		
	ALK Neutral	X Industry	S&P 500	JBLU Neutral	LUV Neutral	SAVE Neutral
VGM Score	A	-	-	B	C	C
Market Cap	8.24 B	4.59 B	23.91 B	5.76 B	29.94 B	2.92 B
# of Analysts	7	3	13	6	13	8
Dividend Yield	2.09%	0.00%	1.77%	0.00%	1.27%	0.00%
Value Score	A	-	-	A	B	B
Cash/Price	0.20	0.24	0.04	0.17	0.14	0.36
EV/EBITDA	8.68	6.14	14.07	8.61	6.78	10.27
PEG Ratio	0.53	0.56	2.00	0.37	1.44	NA
Price/Book (P/B)	1.90	1.20	3.27	1.21	3.05	1.34
Price/Cash Flow (P/CF)	6.75	5.20	13.48	5.27	8.51	5.99
P/E (F1)	9.19	9.13	18.76	8.21	12.36	8.57
Price/Sales (P/S)	0.94	0.64	2.61	0.71	1.34	0.79
Earnings Yield	10.72%	10.95%	5.32%	12.19%	8.09%	11.66%
Debt/Equity	0.62	0.64	0.72	0.43	0.30	1.32
Cash Flow (\$/share)	9.91	3.94	6.88	3.79	6.69	7.13
Growth Score	B	-	-	B	C	F
Hist. EPS Growth (3-5 yrs)	-2.40%	3.32%	10.68%	0.16%	7.94%	3.40%
Proj. EPS Growth (F1/F0)	11.66%	14.16%	7.73%	27.89%	7.76%	-0.47%
Curr. Cash Flow Growth	28.26%	5.74%	12.29%	11.76%	-3.22%	28.39%
Hist. Cash Flow Growth (3-5 yrs)	7.83%	8.55%	8.78%	14.43%	8.55%	18.42%
Current Ratio	0.64	0.70	1.23	0.53	0.67	1.33
Debt/Capital	38.43%	47.20%	43.16%	30.18%	23.31%	56.96%
Net Margin	8.76%	5.81%	11.59%	7.03%	10.26%	9.29%
Return on Equity	19.58%	14.71%	17.38%	12.13%	23.31%	17.52%
Sales/Assets	0.68	0.66	0.54	0.72	0.85	0.60
Proj. Sales Growth (F1/F0)	5.24%	4.83%	4.05%	7.49%	4.18%	15.60%
Momentum Score	B	-	-	D	F	B
Daily Price Chg	2.06%	0.00%	-0.21%	-1.63%	-1.23%	0.73%
1 Week Price Chg	0.15%	-2.69%	-1.09%	7.47%	2.80%	-1.93%
4 Week Price Chg	-1.27%	-5.77%	-0.01%	6.52%	5.39%	5.95%
12 Week Price Chg	-6.28%	-5.29%	4.14%	1.42%	-1.68%	8.98%
52 Week Price Chg	3.45%	-10.77%	17.24%	8.61%	-1.04%	-28.13%
20 Day Average Volume	1,253,765	107,415	1,824,613	6,328,574	4,714,279	1,246,010
(F1) EPS Est 1 week change	0.12%	0.00%	0.00%	3.42%	-4.24%	0.00%
(F1) EPS Est 4 week change	1.68%	0.00%	0.00%	3.48%	-5.42%	1.12%
(F1) EPS Est 12 week change	1.88%	3.19%	-0.11%	3.99%	-7.07%	3.90%
(Q1) EPS Est Mthly Chg	14.15%	0.00%	0.00%	-30.00%	-0.03%	0.94%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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