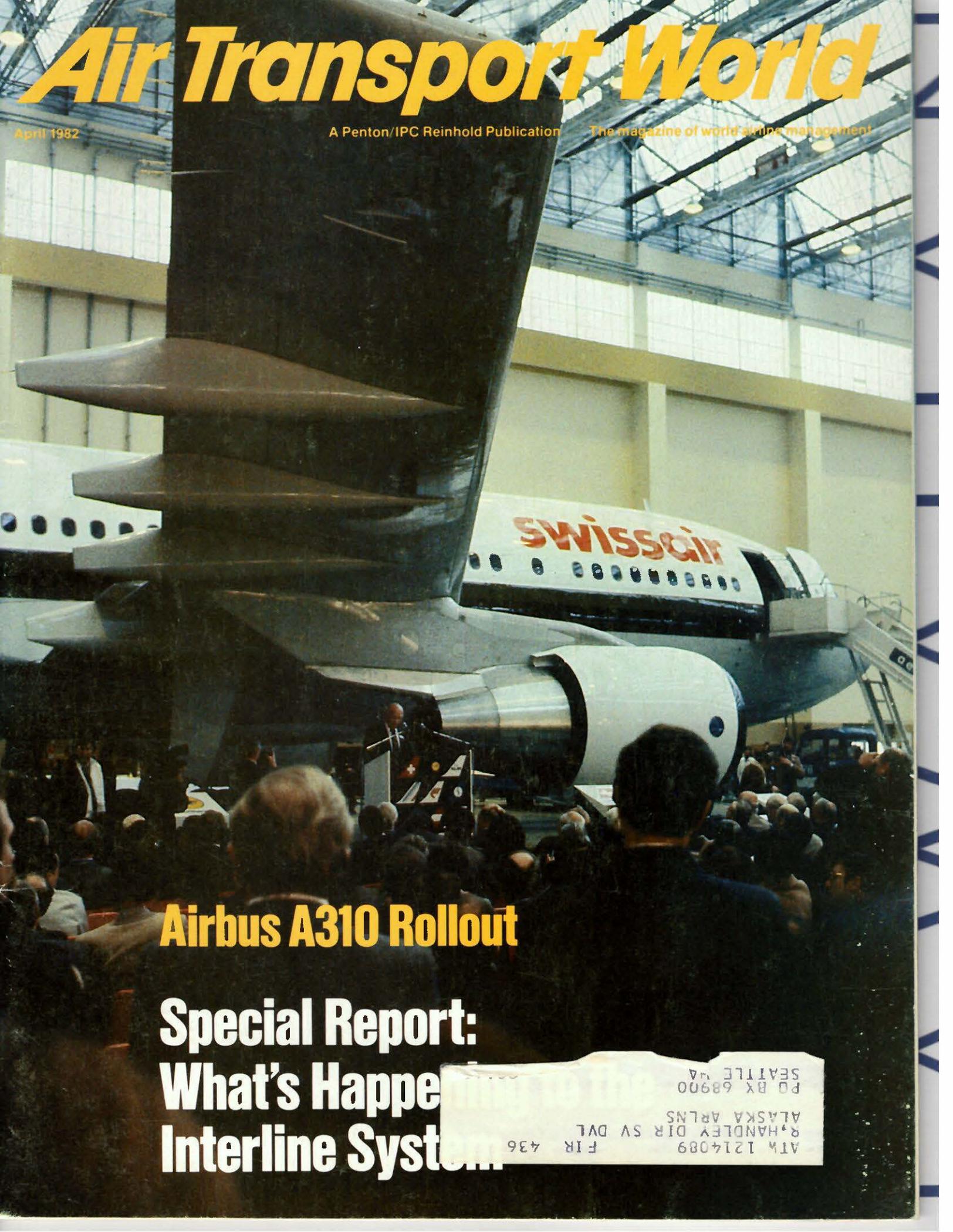


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Alaska Airlines finds operations can be profitable in Alaska

Airline is a consistent profit maker tailoring its service to Alaska's unique requirements, but competitive challenges loom in the future. *By Joan M. Feldman.*



Alaska—Next month, the current management at Alaska Airlines celebrates its 10th anniversary. Not very coincidentally, Alaska also recorded its 10th year of profits in 1981.

Given the roller-coaster nature of airline finances in the last decade, toting up of annual profits over the decade is a feat accomplished by only a few carriers. Yet, until very recently, Alaska's quiet, conservative management was relatively unheralded.

That is beginning to change. The company gradually has taken advantage of the deregulated route environment to expand its system south of Seattle, to balance seasonality and fill Alaskans' needs to seek the sun. It is making its presence felt still more within Alaska, where it no longer is precluded from competing on former monopoly routes. Most importantly, because of its steady profit record, the financial community has begun to sit up and take notice, enough to support two successful stock offerings last year that netted the company almost \$20 million in additional capital.

None of this has come easily to the young team of Ronald F. Cosgrave and Bruce R. Kennedy who invested in a debt-ridden airline in 1970 and wound up taking over active management in 1972 when their investment was threatened. Cosgrave served as head of the company until 1979, when a takeover fight for Wien Air Alaska resulted in his handing over the chairmanship to Kennedy, who by then was already president and chief operating officer.

Can expand now

The Cosgrave-Kennedy team fought a lot of battles: regulation; Alaskan politics and politicians, the airline's previous image of derring-do, flamboyance and financial mismanagement; the idea within Alaska that the carrier's Seattle base made it a kind of pirate; and some stiff competition on its Seattle-Alaska routes.

The result is a company that can now afford to expand, that is able to compete with larger carriers, and that is confident of surviving the current economic climate.

While airlines in the "lower 48" are suffering from the economic recession and the depressed yields caused mostly by



Kennedy

Alaska Airlines Five-Year Summary

Selected Financial Data (thousands)

	1981	1980	1979	1978	1977
Airline operating revenue	\$181,960	130,850	98,200	84,246	76,518
Airline operating income	14,107	5,105	2,279	8,671	8,064
Airline net income	7,674	5,128	3,024	6,159	3,511

Selected Operating Data

	1981	1980	1979	1978	1977
Revenue passengers (thousands)	1,310	1,070	1,023	933	851
Revenue passenger miles (millions)	1,062	871	834	783	672
Available seat miles (millions)	1,696	1,438	1,371	1,185	1,122
Passenger load factor (%)	62.6	60.6	60.8	66.1	59.8
Breakeven load factor (%)	58.5	60.2	61.0	59.5	54.2

their fare wars, Alaska Airlines seems to be in another part of the world, enjoying a \$7.7 million net from \$182 million revenue. Kennedy is positively excited by his airline's 1981 performance. He is especially pleased with the reception he has received when going out to raise money.

"Twice we went to the equity market," he points out, "first in March with a

\$14,375,000 preferred/common stock issue, and again in September with a common stock offering worth \$6,375,500." Not only were both issues sold out, but, Kennedy noted, current shareholders, including Kennedy and Cosgrave, suffered little or no dilution in their holdings.

Given its profit record, one would expect Alaska to be discussing purchase of new-technology aircraft. Not so. Alaska's fleet now includes seven Boeing 727-200s, five 727-100s with gravel kits, and three 737-200Cs. Two used 727-200s, one leased and one a lease-purchase, will be operated this summer, and a fourth 737-200C with a gravel kit will be delivered next year.

What Kennedy really wants is a re-engined 727-200. The \$15 million price for that aircraft, versus the \$25 million projected as the 757 purchase price, is the deciding factor for Kennedy. As for the vaunted labor savings of a two-place crew 757 versus a three-place crew 727, Kennedy answered pointedly, "That third man is a cheap man."

Moving cautiously

Thus, despite the infusion of capital last year, Kennedy has no plans to blow all the proceeds on new aircraft. Not in this economy, and certainly not in a deregulated environment where he needs to conserve resources for competitive ventures.

Alaska backed deregulation, but Kennedy is realistic about his carrier's place in such an atmosphere. For example, Alaska once thought about expansion east to Minneapolis/St. Paul. That idea is no longer viable, he says. "Delta can make long-range (route) plans and have credibility," says Kennedy. It has the resources to stick to such plans, even if some competition comes along in the meantime. "But an Alaska-size airline has to be an opportunist. When Continental pulled out of Burbank and Ontario, we seized the opportunity and made it work."

Lest Alaska's opportunism be thought to be a short-term tactic, Kennedy interjects, "We do go in thinking we have enough

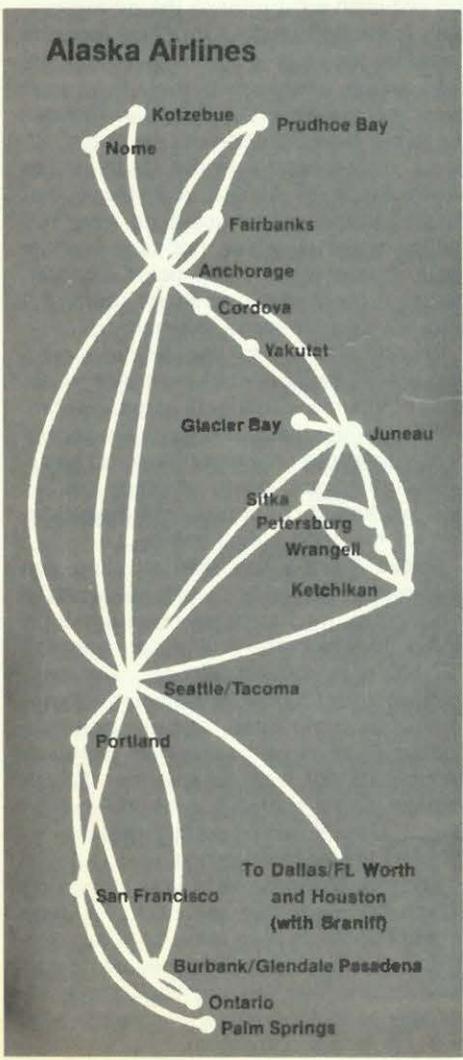
strength for the long-haul. (But) if Burbank and Ontario had been a drain, we would have pulled out. That's part of the reality of being small in an industry dominated by bigness."

Therefore, Alaska has not resorted to Braniff-type expansion tactics. It began serving Portland and San Francisco in 1979, both new markets; Nome and Kotzebue, AK (which it served prior to Wien's being given the monopoly there) and Palm Springs, a new market in 1980, and Burbank, Ontario and Prudhoe Bay in 1981.

Kennedy would have liked to continue adding points at a three-a-year rate. But the recession and the depressed fare yields engendered still more caution in this already-conservative businessman. This year, Alaska has its eyes on both Long Beach, which would complete the circle around Los Angeles International Airport, and Seattle-Kodiak, a route it selected as its last automatic entry point under the Airline Deregulation Act of 1978. Whether, and when, those routes will be started soon is another matter.

This does not mean the company is not growing. On the contrary, resources are being used to beef up already-established services, to modernize facilities system-wide and to take still more advantage of the carrier's Alaskan presence. Alaska, after all, is a place that is basically recession-proof, an area whose future depends on oil, gas and other resource exploration, rather than the normal economic influences.

Indeed, Alaska's establishing a separated region, so far its only one, in Anchorage, plus expenditure of \$4.5 million on new facilities at Prudhoe Bay attest to its determination to dominate Alaskan commercial airline operations. That is no easy task. While Alaska already is the predominant carrier of Alaska-U.S. traffic—42% of the market in the year ended Sept. 30, 1981—Western Airlines is a threat. Western, traditionally a major carrier in Alaska, has a new chairman, Neil Bergt, who made his mark in the state and who, not coinci-



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Alaska Airlines continued

dentally, wants to merge Western with Wien. (Kennedy and Bergt once were neighbors in Fairbanks.) Bergt also owns Alaska International Airlines, which like Alaska Airlines used military Lockheed Hercules in commercial cargo operations.

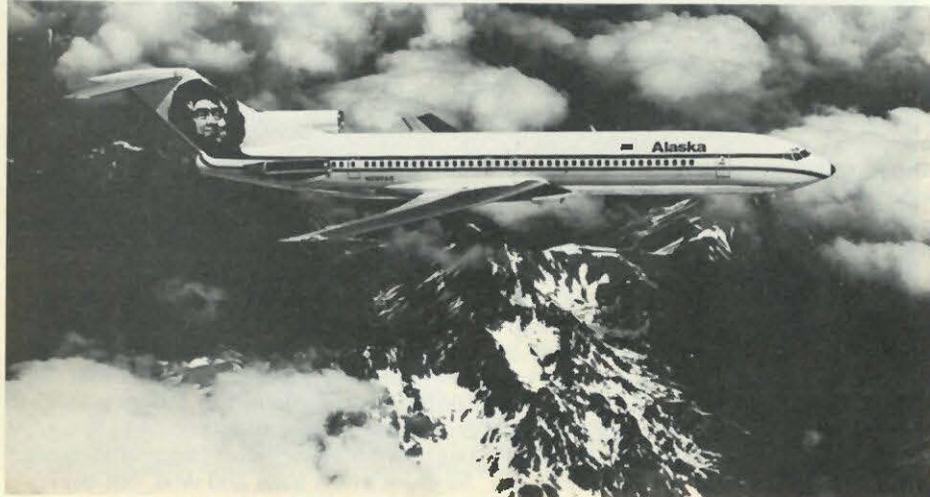
Kennedy is not quite shuddering in his boots. But his and Cosgrave's idea all along has been to try to match the kind of service for which Western was once known. "I'd be cheering him (Bergt) on," in

his efforts to revitalize Western, Kennedy says, if it weren't for the fact that most of Alaska's competition within the state then would be organized under one owner.

In addition, Kennedy must keep an eye on big Northwest Airlines which has shown more competitive verve since deregulation, and could become more of a force in Alaska.

While Seattle is Alaska Airlines' corporate headquarters, the Anchorage facilities are a major focus of the company's operations. The airline recently appointed a new

Alaska Airlines has a fleet of seven 727-200s. The carrier has no plans to purchase new technology aircraft such as the 757, but would like to re-engine a 727-200.



regional VP-Alaska to reflect that fact, and it opened a new regional office/warehouse in 1978. The crew base is in Seattle, but there also are several 737 crews in Anchorage to reduce deadheading and weather delays.

The reasons for the activity in Anchorage are not difficult to ascertain. The Fairbanks-Anchorage-Seattle route accounts for 38% of the carrier's revenue and profits, while southeastern Alaska traffic produces another 32%. The oil companies' Prudhoe Bay employees spend half of their time in Anchorage, and most of the air cargo to Prudhoe flows via Anchorage.

While Anchorage may be the airline's operating hub in Alaska, that is not the same thing as saying that Anchorage is Alaska. In fact, Richard G. Grissom, the airline's regional customer service manager in Anchorage, and a longtime Alaskan resident, insists, "Anchorage is the closest (U.S.) city to Alaska."

If one wants to get a feel for what all Alaskan operators must contend with, technological advancements notwithstanding, it is instructive to visit Prudhoe Bay. A commercial, scheduled passenger actually flies to Deadhorse, the name of the commercial airfield once owned by Sohio and now the property of the state. Technically, Deadhorse, which did not even exist prior to the oil exploration, is located next to Prudhoe Bay, the name for the oil field complex. But no one pays much attention to that. You can't even find the word Deadhorse in Alaska's timetable. Now Deadhorse is the hub of airline and air-related activities for the entire North Slope of Alaska. It is there that Alaska Airlines constructed its new \$4.5 million terminal, which not only has the usual cargo warehouse, ticket counter, baggage claim and operations room, but also housing for some 30 employees.

Anyone working for the airline is on a two-weeks-on/two-weeks-off schedule. That compares with the oil company staff, which shuttles back and forth to permanent residences on a one-on/one-off basis. This coming and going of office and oil field workers is, of course, the major reason for the good airline traffic.

Alaska Airlines was slow to jump into this market, however. It did not want to jeopardize its lucrative contract with Sohio, to which the airline has leased a 727-100 with ground services. The contract, in effect since 1975, was a charter until Wien complained. "It's as good as a charter in revenue," explained Kennedy, and he did not want to lose that. So, although Alaska started service to Prudhoe Dec. 8, 1981, Sohio "is so big" that they've retained the lease operation.

Second, Wien already was providing scheduled passenger service to Prudhoe in addition to its own lease contract with ARCO. AIA also provides scheduled cargo services and Western, wanting to take advantage of its Alaskan service history, also was a potential competitor.

Third, the construction season in the far north has such a small window that it took time to get the terminal built. But, based on oil and gas activity projections (the Prudhoe oil field won't even reach peak production until next year, much less all the other projects) Alaska went ahead. Western started Prudhoe Bay service six days before Alaska, but pulled out within two weeks, allegedly only after Bergt found out that the airline he was chairing was going to be competing with an airline (Wien) he was trying to take over. Kennedy insists, "There's not room for three scheduled airlines up there."

Possible Hercules service

Now that Alaska Airlines has permanent facilities on the North Slope, it is considering the possibility of reinstating the Hercules cargo services which it originated in the early days of oil field activity. When Cosgrave and Kennedy took over in 1972 they got rid of the Hercules fleet. Because of pipeline construction delays, until 1974, "They were eating us alive," says Kennedy. They also distracted management from the scheduled passenger operations."

But prospects for the new gas pipeline, new oil fields and development of other resources have Kennedy thinking again about Hercs. "But," he warns, "if we go back in, I want to do it with a separate cargo division."

While visions of cash registers ring in the heads of most people doing business on the North Slope, life is not easy there. It also is extremely costly. For example, the airline sends all its trash from the Slope to Anchorage for disposal. The local authorities charge too much for dumping.

David Buchanan was customer service manager when we visited. With only six weeks of operation under his belt, traffic had been slow. But, Buchanan said, the company started up during the traditionally slow season. Additional Prudhoe Bay oil production is expected to generate more traffic by March.

Our return from Prudhoe was marked by a delay, due to weather in the southeastern part of the state and the need to accommodate more cargo carriage from Anchorage. Alaskan travelers are no happier about delays than anyone else. There is one big difference, however, from "lower 48" travelers. There is no alternative to air. Alaska's lifeline, for both people and commerce, depends on aviation. In fact, it is difficult to determine which would suffer most in Alaska without airplanes: the travelers, including businessmen and residents, or the shippers and those on the receiving end of cargo shipments.

Two important facts drive air cargo operations in Alaska. First, there are no roads, so air is the only year-round form of transport for food, mail and other necessities. Second, inventory costs at both ends of a shipment make rapid air delivery a requirement, not a luxury.

The only problem is that cargo flows

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primarily in a northerly direction. The most important product coming south—oil—is delivered by pipeline. As a result, juggling passengers and pallets creates a tremendous headache. But it is a headache a common carrier must suffer, if it is going to stay in business, and one that the oil companies, particularly, are willing to help ease, through higher rates.

Demand for first-class

Todd Wallace, cargo marketing manager in Anchorage, showed us an almost empty warehouse. The airline's goal is to move cargo within 24 hours. ARCO's goal at Prudhoe is 12 hours. When the passenger seats aren't needed in the 737Cs, they're replaced by igloos to keep supplies and mail moving. The airline has one ad that reads: "The Best Little Warehouse in Alaska."

While providing a lifeline is necessary to any Alaskan common carrier, that task conflicts with Alaska Airlines' bid to make itself the choice of the first-class traveler, particularly between Seattle, Anchorage and Fairbanks, which are its top three markets, in that order. In fact, its desire to sell first-class seats (it could sell at least another row on every flight, says market development director Gary Odle), resulted in a re-evaluation of its Pipeline Express interchange with Braniff, to Texas. Because Braniff has switched its domestic services to one-class, it is awkward for

Alaska to sell first-class seats and operate its own two-class aircraft in the interchange.

One answer is to find another interchange partner. Another would be to operate to Texas itself. But, says Kennedy, Alaska's place is as a north-south airline. That is why the carrier dropped plans to serve Minneapolis-St. Paul. "You need feed in a deregulated environment," he feels. Discussions about the interchange were being held as ATW went to press.

Alaska's expansion into California is another story. Once south of Seattle, the West Coast markets are high-density, low-fare and passenger-oriented. Thus, while Kennedy and his marketing staff feel expansion into the southern markets is necessary to create some seasonal balance the service requires yet another "image."

Many airlines, of course, would be happy to have merely "image" problems to worry about. Yet, although Alaska's finances are in good condition, Kennedy's managers are not complacent, particularly in the current economic environment and particularly with Neil Bergt's potentially powerful combination of carriers looming.

The CAB has required hearings on the Bergt Western/Wien/AIA maneuverings, and is required to make a decision by July. Perhaps then more will be known of Alaska Airlines' competition and how much of its profitable existence is threatened.

Facts and Figures

Freight Traffic

World Airline Traffic — 1981

Month of January 1982 vs 1981 (U.S. Airlines)

Transatlantic

Rank	Airline	Frt. Ton-Kilometers		
		1982 (000)	1981 (000)	% Chg.
9	Air Florida	262	—	—
5	Braniff Int'l.	1,867	2,199	(15.10)
8	Capitol	305	289	5.54
6	Delta	1,745	1,108	57.49
1	Flying Tigers	62,973	48,196	30.66
4	Northwest	8,911	10,103	(11.80)
2	Pan Am	52,342	45,188	15.83
10	Transamerica	11	—	—
3	TWA	18,458	16,443	12.25
	Western	—	54	—
7	World	486	—	—
	Total	147,360	123,580	19.24

Transpacific

4	Continental	3,999	1,983	101.66
1	Flying Tigers	56,548	47,970	17.88
2	Northwest	23,582	21,087	11.83
3	Pan Am	16,448	13,939	18.00
	Total	100,577	84,979	18.36

Source: CAB Form 41

Airline	Pass. (000)	1981/ 1980		RPKs (000)	1981/ 1980		Frt TKs (000)	1981/ 1980		Jan. Thru.
		%	Chg.		%	Chg.		%	Chg.	
Air Canada	13,081	(5.6)		20,869,714	(5.8)		425,137	2.6		Nov.
Air Inter	8,641	11.9		4,633,327	14.2		13,630	17.4		Dec.
Air Jamaica	677	—		1,039,475	(13.0)		10,915	13.0		Dec.
Air New Zealand	4,025	(4.1)		5,681,309	0.3		198,865	7.2		Dec.
Air Panama Int'l	139	(2.8)		236,040	(11.6)		—	—		Oct.
Alia	1,443	30.0		3,170,917	22.0		111,857	40.0		Dec.
Avianca	3,329	(9.0)		3,251,797	1.0		178,855	29.0		Nov.
Braathens SAFE	2,191	0.8		2,196,430	7.5		4,559	3.5		Dec.
Britannia	2,709	—		5,000,175	—		—	—		Aug.
BWIA	1,200	(2.1)		1,343,515	(7.3)		7,141	58.4		Nov.
Caribbean	61	12.0		428,322	10.0		313	(63.5)		Dec.
China Airlines	2,352	8.8		4,900,975	11.4		304,624	60.1		Dec.
CP Air	3,231	5.8		8,896,545	3.4		171,722	7.5		Nov.
Cruzeiro	2,281	(6.0)		2,274,980	(6.0)		25,323	18.0		Dec.
Cyprus	455	3.2		855,156	7.2		16,464	—		Dec.
Finnair	3,098	8.0		3,786,238	9.1		51,870	7.1		Dec.
Gulf Air	2,311	10.8		3,283,656	15.1		85,470	(18.6)		Dec.
Iberia	13,209	(3.6)		15,389,709	3.5		425,375	7.4		Dec.
Inex Adria	982	12.0		845,972	3.0		951	(13.0)		Oct.
IPEC Aviation	—	—		—	—		7,840	1.7		Dec.
JAL	13,881	4.5		32,413,928	9.7		1,778,419	10.6		Dec.
Kar-Air	98	(27.1)		108,440	(47.0)		28	27.3		Dec.
LAN-Chile	375	23.2		1,431,327	23.0		75,332	(5.4)		Oct.
Lufthansa	13,894	(0.4)		21,721,650	2.9		1,514,212	(0.8)		Dec.
Malaysian	4,740	16.5		4,181,514	14.7		115,230	16.0		Nov.
Olympic	4,901	—		5,196,427	3.0		78,188	11.0		Dec.
Pacific Western	4,173	3.8		2,495,313	13.2		56,361	0.5		Dec.
Philippine	1,099	8.2		5,518,684	11.9		179,262	36.9		Dec.
Royal Brunei	126	18.0		137,493	19.0		4,014	21.0		Dec.
SAS	8,416	1.0		10,815,653	(1.0)		416,138	3.0		Dec.
South African	4,005	0.6		9,279,392	4.9		311,066	19.4		Dec.
TAP-Air Portugal	2,077	10.4		4,007,792	16.9		100,405	(4.7)		Dec.
Thai Int'l.	1,949	15.3		6,510,435	19.5		242,073	10.6		Nov.
UTA	937	7.2		5,058,615	8.2		486,447	3.2		Dec.
Varig	4,460	—		9,234,547	6.0		561,022	5.0		Dec.

Source: Direct Airline Reports

U.S. National Carriers

Scheduled Operations Month of January 1982 vs 1981

Airline	Rank	Scheduled Passengers		Rank	Scheduled RPMs		Rank	Scheduled ASMs		Rank	Load Factor		Rank	Average Length of Trip	
		1982/ 1981 (%)	% Chg.		1982/ 1981 (%)	% Chg.		1982/ 1981 (%)	% Chg.		1982/ 1981 (%)	% Chg.		1982/ 1981 (%)	% Chg.
AirCal	7	257	2.39	9	100,036	9.92	9	203,195	26.56	10	49.2	(7.5)	9	389	7.16
Air Florida	8	145	(7.05)	10	89,222	(4.44)	10	198,677	31.27	11	44.9	(16.8)	4	614	2.68
Alaska	11	97	21.25	11	78,875	19.07	11	142,339	30.03	4	55.4	(5.1)	3	813	(1.81)
Capitol	10	103	267.86	4	192,922	252.14	8	276,223	298.14	1	69.8	(9.2)	2	1,867	(4.60)
Frontier	3	503	(1.37)	1	286,983	6.11	1	499,246	9.35	3	57.5	(1.7)	6	571	7.74
Ozark	5	317	(8.65)	8	151,504	1.81	7	301,783	6.55	6	50.2	(2.3)	7	478	11.42
PSA	4	496	11.71	5	181,649	18.05	3	363,693	15.60	7	50.0	1.1	10	366	5.48
Piedmont	1	558	22.64	2	252,567	24.58	2	494,450	19.05	5	51.1	2.3	8	452	1.35
Southwest	2	551	(4.51)	6	169,611	(0.65)	5	308,738	11.84	8	49.9	(11.9)	11	308	4.05
Texas Int'l.	6	291	(16.14)	7	167,226	(12.73)	4	335,141	10.12	8	49.9	(13.1)	5	575	4.17
World	9	106	(15.20)	3	204,464	(18.06)	6	304,354	3.01	2	67.2	(17.3)	1	1,937	(2.69)

Source: CAB Form 41