

OREGON BUSINESS

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THE ALASKAN ECONOMY
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A NEW SKY KING

Alaska Airlines has become the major carrier with the most service to Portland. But the competition is getting tougher.

ALASKANS ENGAGE IN PACKWOOD BASHING

SELLING EUGENE TO INDUSTRY AND TOURISTS

THE STATE'S 50 BIGGEST CONSTRUCTION PROJECTS

**Bruce Kennedy, Chairman
Alaska Air Group**



A NEW SKY KING

Alaska Airlines has used clever commercials to help build itself into the major carrier with the most flights serving Portland and Seattle. Now it is facing new challenges.

BY ROBERT L. HILL

The traveler steps up to the airline ticket counter, only to face a large video screen. He puts his credit card in a slot in the counter, a smiling female face appears on the screen and says, "Hello, I'm your automatic ticket dispenser. Your destination, please," and the man replies. "Smoking or nonsmoking?" the woman/screen asks. "Non-smoking," he answers. An airline ticket zips out of a slot in the counter. As the man takes the ticket, the woman on the screen instructs, "Please place your luggage in our automatic luggage conveyor slot at your feet." The man begins to protest, "But I don't have any luggage" when a suitcase-size slot in the counter opens, and, with a gush of air, the man's pants are sucked off through the opening. As the man stands there in his underwear looking perplexed a voice intones the message that, if you want more personalized service, you should fly Alaska Airlines.

This television commercial is the latest in a line of entertaining and award-winning Alaska Airlines spots produced by

Joe Sedelmaier, the Chicago advertising whiz who is responsible for many of the "atrocious" commercials on television, those spots that depict dire happenings to the user of a competitor's product or service. In fact, this new commercial has not even aired yet; it is scheduled to make its debut during the Super Bowl telecast in January.

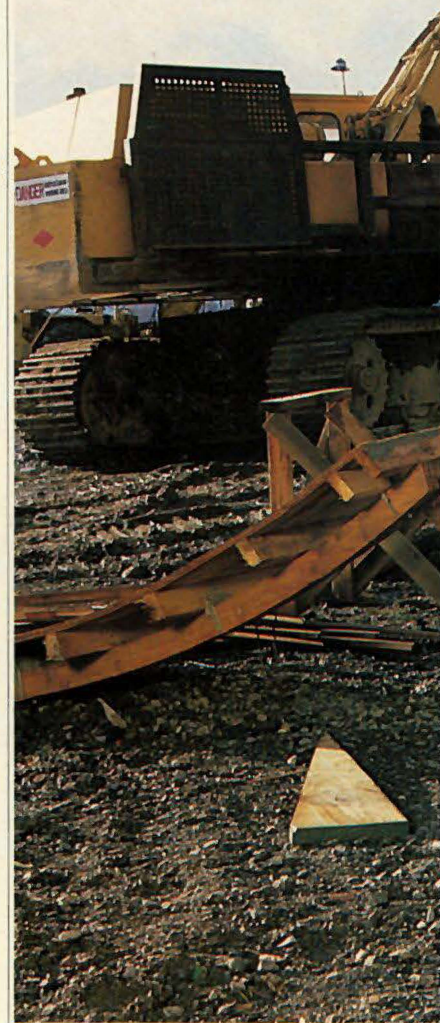
The new commercial is more than a little symbolic. If financial results are compared, Alaska Airlines has been beating the pants off competitors along the west coast for quite some time. The next challenge facing Alaska Air is to continue that success in the wake of fare wars that have spread throughout the west coast.

Alaska Air has enjoyed 12 straight years of profitability. This includes the last seven under airline deregulation, which sent several major carriers down in flames. Alaska, meanwhile has been flying high, enjoying not only profitability, but also four straight years of record-setting revenues and profits. And 1985 should prove to be number five in that string. The company's 1984 return on shareholders' equity at 24.4% (see tables, pages 24 and 94) was among the highest in the industry and larger than any of the

major nationwide carriers, according to data supplied by E.F. Hutton & Co. Alaska ranks 21st in size among U.S. airlines. (The corporation recently set up a holding company, Alaska Air Group, Inc., as the parent company of Alaska Airlines, its only subsidiary. The company is listed under the holding company name in investor-related information.)

In the last four years, Alaska Air has doubled in size as it changed from a carrier primarily serving Alaska to one which now intends to be "the dominant carrier between the Pacific Northwest and the San Francisco Bay area and southern California," the stated goal of Bruce Kennedy, the 47-year-old chairman and chief executive officer of the company. (Kennedy, comparatively young to be CEO of a corporation of Alaska Air's size, is typical of the management team. Eight of the 11 top executives are 47 or younger, and only one is over 60.)

The carrier has gone a long way toward achieving its goal of regional dominance. In 1980, only 7% of Alaska Airlines passenger revenue came from routes out-



ALASKA AIR GROUP HISTORICAL SUMMARY

DOLLAR AMOUNTS IN MILLIONS, EXCEPT PER-SHARE FIGURES

	1985*	1984	1983	1982	1981
TOTAL REVENUES	\$438.6	\$361.6	\$280.6	\$234.5	\$182
NET INCOME (LOSS)	29.4	23.9	15.7	10.6	7.7
NET INCOME (LOSS) PER SHARE (FULLY DILUTED)	2.00	1.93	1.44	1.15	.97
BOOK VALUE PER SHARE	—	10.12	8.05	6.65	6.47
RETURN ON AVERAGE SHAREHOLDERS' EQUITY	—	24.4%	20.1%	18.5%	24.8%

* Estimates from William Whitlow, Jr., financial analyst in the Seattle office of Dain Bosworth, Inc.
SOURCE: 1984 Alaska Airlines Annual Report

the 1988-1990 period, and United plans to buy 116 jets worth \$3 billion from Boeing, with delivery before 1991.

Rent, Don't Buy, Planes

Alaska Air itself is in the midst of a purchase of nine McDonnell Douglas MD-83 jetliners for a total of \$212 million. These mid-range planes, specially designed for quiet operation, will be used to serve noise-sensitive airports in southern California.

A major purchase like this is somewhat of a departure for Alaska. It has tended to avoid large capital commitments by buying only used planes and leasing new ones. This has enabled the airline to maintain one of the lowest debt burdens in the industry. Its debt-to-equity ratio has hovered in the 40% to 50% range in past years.

Kennedy also has been committed to stringent cost control in most other areas, too, aside from changing the airline's image as one that is committed to offering a higher level of service than its competitors. This high level of service results in the airline having one of the highest operating cost levels in the industry. (For a comparison of operating statistics for several different airlines, see table, page 24.) But Kennedy is committed to controlling labor costs, too, before they begin to present financial problems.

To show its resolve, the company went through a strike last March, April and

May by its mechanics and related employees. But it emerged from that strike with its major goals: a new two-tier contract that provides for lower wages for starting employees, more flexible work rules, and greater use of part-time employees.

Throughout the industry, Kennedy said, unions "are slowly becoming aware of the problems" facing the airlines and "are becoming more enlightened" in their approach to contract bargaining. About 85% of Alaska Air's employees are covered by union contracts. The company's employment should average about 3,000 in 1985. In 1984, wages and benefits were about one-third of Alaska's operating costs, versus 23% for a discount carrier such as Continental.

One of the main reasons the company is attempting to lower its labor costs is the realization it was facing an increasingly competitive situation as it entered more populous Sun Belt markets. That point was driven home to the company this past fall as fare wars erupted not only in service from the Northwest-to-Los Angeles market, but also in the Northwest-to-Anchorage market, previously immune to this marketing tactic.

The result of this fare cutting showed up in Alaska Air's third quarter results. This quarter is typically the company's most important because of the Alaska tourist traffic. Historically, revenues in Alaska's third quarter have equaled all the other three quarters combined. With the fare wars this past fall, Alaska was

able to report higher profits and revenues than the previous year, but its per-share earnings fell to 86 cents from 96 cents the year before, far below the level market analysts had expected. In a September "Research Memo" issued by the Seattle office of Dain Bosworth, Inc., market analyst William Whitlow, Jr. predicted per-share earnings in the third quarter for Alaska of between 96 cents and \$1.15. At the time, he predicted year-end results that would show fully diluted earnings per share of \$2.40, an increase of 24.4% over 1984's \$1.93.

Whitlow now says, after seeing the third quarter results, that he has revised his 1985 earnings estimate downward to about \$2, an increase of only 3.6%. (In the past year, Alaska has increased the average number of primary shares outstanding by almost 1.4 million shares through a \$28.5 million public stock offering last February.)

Whitlow said he was "very disappointed" with the third quarter results. He said he had thought Alaska Air would be "relatively immune to fare cutting," but that he was wrong. In the near term, the earnings outlook for the company "is not so favorable," but for the long-term he sees the stock as still being a good buy, particularly at prices below \$20 per share. The stock was trading at around \$20 in November.

Whitlow cautioned, however, that fare wars are always a concern, particularly if they last for very long. "They could really hurt (Alaska Air) if they continue into next summer. That is the key."

In the past, Alaska had been able to operate with relative impunity from a solid base of operations in the 49th state. The airline now faces the competition of United, which started service to Anchorage in 1983. Alaska Air also competes in the market with Western and Northwest. However, the company still claims a commanding share of the Alaska-lower 48 market — 41% earlier this year.

One of the biggest events that hit the airline industry this past year, outside of mergers, was the purchase of the Hertz

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SELECTED AIRLINE 1984 OPERATING STATISTICS

REVENUE PASSENGERS	AIRCAL	ALASKA	CONTINENTAL	HORIZON*	NORTHWEST	UNITED	WESTERN
REVENUE PASSENGERS CARRIED	3,989,867	2,543,000	11,100,000	659,861	13,216,000	41,273,000	8,307,000
PASSENGER LOAD FACTOR	55.1%	52.2%	62.7%	52.2%	60.5%	60.4%	57.7%
BREAKEVEN LOAD FACTOR	50.2%	46.8%	59.8%	48.6%	57.6%	N/A**	59.9%
YIELD PER REVENUE PASSENGER MILE	17.7¢	17.1¢	9.4¢***	32.2¢	10.04¢	11.6¢	11.1¢
COST PER AVAILABLE SEAT MILE	9.3¢	9.3¢	6.2¢	17.7¢	7.11¢	7¢	7.2¢

* Fiscal year ending September 1984. ** Not Available. *** First six months of 1985.
SOURCE: 1984 annual reports or other company supplied data.

ALASKA AIRLINES

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company by UAL, Inc., the parent company of United Airlines. With the acquisition of the nation's largest car rental company, combined with its existing Westin hotel chain, industry analysts speculated that United could become even more dominant in the travel industry and use its ability to offer deals with its other subsidiaries to take business away from other airlines.

But Kennedy is not too worried about the additional possibilities the purchase of Hertz might offer United. There are a number of areas in which Alaska can't compete with United, such as its reservation system and extensive frequent flyer program, Kennedy said, but Alaska can compete by offering better service.

Plastic Parsley And Pygmy Chickens

Superior service and food have been the keystone of Alaska Air's television commercials which humorously claim other airlines have crowded conditions and inferior food. John Kelly, vice president of marketing for Alaska Air and the man responsible for the commercial campaign, said one of the first of that series of commercials — featuring airline passengers looking forlornly at a tiny doughnut on their seat trays — almost wrote itself. Kelly said he had traveled to Los Angeles several years ago and at the time had to take another airline. It was a major carrier which Kelly wouldn't name, but he said when the passengers were served only a small doughnut for breakfast, "it was even embarrassing for the flight attendants." This offered Kelly a "marketing person's dream," a classic case of product differentiation in which

"you have the clearly superior product." With Alaska's commercials, Kelly said, "for once, someone admits there are problems with flying." Alaska's message is that "we can help the traveler avoid or make more pleasant these problems. We are trying to offer traveling like it used to be." In addition to the soon-to-be released spot featuring the passenger's pants being sucked off, another spot emphasizing the bad food on competitor airlines will show meals with plastic "re-usable" parsley and pygmy chickens about the size of a thumbnail.

The "automatic ticket machine" commercial appears to be a direct slap at PSA airlines, which has recently been sending out press releases touting the time-saving aspects of its automated ticket machines. Comparing them to bank automatic tellers, PSA claims customers are "delighted" with the machines — which do not feature automatic luggage handling.

Looking to the future, Kennedy does not see a continuation of the 20%-per-year revenue growth enjoyed the past few years. He predicts 1986 revenue growth could drop below 15% and be 12% to 15% over the long term. On expansion of the system, Kennedy said Alaska has no plans to go into other Oregon cities, since Alaska Air's jets are too big to serve the available traffic there cost-effectively. But Alaska will continue to add cities to its system, probably at the rate of two to five a year. Kennedy sees service to Denver as a possibility and that Alaska could even extend all the way to the east coast, perhaps by offering direct service between Portland and Seattle and east coast cities. Securing direct service to the east is a current primary goal of the Port of Portland.

"We have found the Portland market good to us," Kennedy said. "We are keeping it central in our thinking." ■

FREE WAY TO ALASKA

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product. Two Goodyear marketing executives flew from Ohio to Anchorage to experience part of the event.

General Electric contributed additional funds for the video work to show how a polycarbonate Lexan the company manufactures protects windshields from flying rocks. The clear, plastic-like material is often used as bullet-proofing in banks and prisons. The clear sheets were cut to fit over the broad motorhome windshield. GE will use the footage for a video news release that will be beamed by satellite to as many as 600 television stations.

Lux, a manufacturer of RV seats, contributed four of its most comfortable units for the event. The company is producing a full color poster of the motorhome to promote its products.

ISSPRO of Portland provided a custom dashboard with special gauges. The 85 miles-per-hour speedometer was not always enough — the motorhome frequently buried the needle while speeding along the long, empty stretches of tundra road.

Other companies contributed road lights, brake pads, electric fuel pumps, airbags for suspension, chrome hub and nut covers, and electric rear-view mirrors. And on and on it goes.

Probably the most unusual contribution came from Apricot Computers, a manufacturer in the United Kingdom. It loaned a computer for word processing. A good bit of the trip it was stowed under the dinette seat, but after 5,000 miles of shaking and jarring it still functioned like new.

The most popular contributor to the event was chef Horst Mager, whose Rheinlander Restaurant provided gourmet sausages and meats, lentil soups, sauerkraut, and brownies. Mager's products made the motorhome the center of social life during the trip. Whenever there was a stop, Gordon heated sausages in the microwave and rallyists filled the RV.

Following the rally, Gordon displayed the motorhome — nicknamed "Rocky II" — at the Specialty Equipment Manufacturers Association show in Las Vegas in November. This is a big event for the automotive industry, and Rocky II captured more than its share of attention, according to Gordon. From there it went to the RV show at Dodger Stadium in Los Angeles.

Gordon is convinced that the more the contributors promote their products through emphasizing the exploits of Rocky II, the more it will help all the other participants — especially him.

He has indeed managed to have his cake and eat it, too: enjoying a trip to Alaska, having others foot the bill, and promoting his products in the process. ■

AIRLINE FINANCIAL RESULTS

	REVENUES	% CHANGE FROM 1984	PROFIT	% CHANGE FROM 1984
AIRCAL	\$ 268.2	20	\$ 14.1	130
ALASKA	330.5	27	25.6	37
AMERICAN	4,642.8	16	321.4	53
CONTINENTAL	1,275.1	52	91.7	156
DELTA	3,570.3	7	154.9	- 16
EASTERN	3,688.1	14	73.8	251.5*
NORTHWEST	2,024.3	8	75.1	- 13
PSA	577.7	11	16.4	2,304*
UNITED**	4,490.9	- 15	- 69.5	- 135.2
WESTERN	1,012.2	12	74.6	414.8*

First nine months of 1985. Dollar amounts millions. *Losses were reported for first nine months of previous fiscal year. **Includes hotel operations and first month of operations of Hertz Corp., the car rental company purchased recently by UAL.

SOURCES: Company press releases and other published sources



United's united with Horizon Air!
And the partnership will mean far greater
convenience for passengers flying in and out
of the Northwest.

United and Horizon have coordinated
their schedules, so you won't have to wait
between flights. You'll be able to fly between
United's cities and Horizon's cities with the
greatest of ease. Tri-Cities to Chicago, for
example, or Sun Valley to New York, or
Yakima to San Francisco. And since you'll be
flying the two airlines, you'll save with
low interline fares.

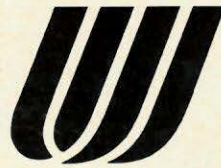
A Bonus for Frequent Fliers.

When flying both airlines on connecting
flights, you'll earn a 20% bonus on a future
United flight with United's Mileage Plus
program. You'll also receive credit for your
Horizon flight with Horizon's Merit One
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United Airlines and Horizon Air...
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