GILDAN ACTIVEWEAR INC
Form 6-K
February 16, 2005
Q1 Quarterly Report

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

**FORM 6-K**

**REPORT OF FOREIGN PRIVATE ISSUER**
Pursuant to Rule 13a-16 or 15d-16 under
the Securities Exchange Act of 1934

For the month of: February, 2005 Commission File Number: 1-14830

GILDAN ACTIVEWEAR INC.
*(Translation of Registrant's name into English)*

725 Montée de Liesse
Ville Saint-Laurent, Quebec
Canada H4T 1P5

*(Address of principal executive offices)*

Indicate by check mark whether the Registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F ___ Form 40-F __X__

Indicate by check mark whether the Registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ___ No __X__

If "Yes" is marked, indicate below the file number assigned to the Registrant in connection with Rule 12g3-2(b): 82-_N/A_.

MESSAGE TO SHAREHOLDERS

On behalf of the Board of Directors, I am pleased to provide results for the three months ended January 2, 2005.

We are pleased to have again delivered sales and earnings growth in excess of expectations. Industry conditions continue to be strong, and the Gildan brand continues to have excellent momentum in all of our served markets.

The Company reported record net earnings for the first quarter of a fiscal year of U.S. $8.4 million or U.S. $0.28 per share, on a diluted basis, compared with U.S. $2.9 million or U.S. $0.10 per share in the first quarter of fiscal 2004. After adjusting prior year results for the impact on cost of sales of revaluing opening inventories, due to the adoption of the U.S. dollar as the Company's functional currency with effect from October 6, 2003, net earnings in the first quarter of fiscal 2004 were U.S. $5.0 million or U.S. $0.17 per share. After adjusting prior year comparatives, the year-over-year increase in net earnings and diluted E.P.S was 68.0% and 64.7% respectively.

Compared to last year, the increase in first quarter net earnings was driven by continuing growth in unit sales volumes, higher selling prices and more favourable product-mix, together with the continuing ramp-up of the Rio Nance textile facility. These positive factors were partially offset by higher SG&A expenses, increased costs for cotton, energy and transportation and the impact of lower capacity utilization on the efficiency of Gildan's Canadian yarn-spinning operations.

Sales in the first quarter were U.S. $109.0 million, representing an increase of 39.8% over the first quarter of fiscal 2004. The significant growth in sales revenues was due to improved selling prices, a 27.5% increase in unit sales volumes, and a higher-valued product-mix within the T-shirt category.

Gross margins in the first quarter were 29.7%, compared with 27.1% in the first quarter of fiscal 2004. Before the impact of the functional currency adjustment on cost of sales in the first quarter of last year, comparative gross margins were 29.8%. The positive gross margin impact of higher selling prices and more favourable product-mix was offset by higher cotton, energy and transportation costs and higher costs for our Canadian yarn-spinning operations.

On February 1, 2005 the Company announced that it is closing its two Canadian yarn-spinning operations, located in Long Sault, Ontario and in Montréal, Québec. The majority of the equipment will be transferred to a new yarn-spinning facility in Clarkton, North Carolina, which will be leased and operated by the Company's yarn-spinning joint-venture with Frontier Spinning Mills.

Gildan's Canadian yarn-spinning facilities provide yarn for its Canadian textile manufacturing operations. In order to be globally cost-competitive, Gildan is expanding its textile operations in Central America and the Caribbean basin, and utilizing its textile operations in Canada to produce shorter-run, higher-value product-lines. This has resulted in lower requirements for commodity yarns from the Canadian yarn-spinning facilities, with the result that they are no longer able to operate at an efficient level of capacity utilization.

Furthermore, under the Caribbean Basin Trade Partnership Act (CBTPA) enacted by the U.S. in 2000, it is not economic for Gildan to utilize yarn from its Canadian yarn-spinning facilities to supply its offshore textile operations, which must use yarn spun in the U.S. in order to be eligible for duty-free access to U.S. markets. Approximately 85% of Gildan's overall sales are currently made to the U.S. The new Central American Free Trade Agreement (CAFTA), which is expected to be implemented by the U.S. in 2005, will also allow duty-free access from Gildan's offshore manufacturing hubs for products using regionally-spun yarn, but this new legislation will still not provide for the use of Canadian yarn.

In addition to the impact of lower capacity utilization on Gildan's Canadian yarn-spinning facilities, their cost structure has also been negatively impacted by the recent appreciation of the Canadian dollar and by the deregulation of electricity costs in the province of Ontario. Electricity is a major input in the cost structure of yarn-spinning operations. The relocation of yarn-spinning to the U.S. will also result in lower transportation costs for both cotton and yarn to be consumed by Gildan's offshore textile facilities. At current exchange rates, Gildan anticipates that the annual cost saving from the relocation and consolidation of its yarn-spinning operations will be in the order of U.S. $4.0 million after-tax, or U.S. $0.13 per diluted share.

The Company is maintaining its full year diluted E.P.S. guidance for fiscal 2005 of approximately U.S. $2.60 per share, before a special charge for the closure of its Canadian yarn-spinning facilities. The resulting special charge, estimated at approximately U.S. $7.8 million after-tax or $0.26 per diluted share, consists mainly of the loss on disposal of fixed assets that are not being transferred to the new U.S joint venture facility and severance costs. This charge will be reflected in the second quarter of fiscal 2005. After taking account of this charge, full year diluted E.P.S. is estimated at approximately U.S. $2.34. The Company's full year earnings guidance reflects unit sales growth of approximately 20% over fiscal 2004, which will fully utilize the Company's available production capacity, and also assumes sequentially lower unit selling prices in the second half of the fiscal year, reflecting the possible flow-through of lower cotton prices. On this basis, full year sales are projected at approximately U.S. $640 million, up approximately 20% from U.S. $533 million in fiscal 2004.

On behalf of the Board of Directors, I wish to take this opportunity to thank our shareholders for their confidence and support.

*Glenn J. Chamandy*
Preisident and Chief Executive Officer

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Gildan Activewear Inc.
Consolidated Balance Sheets
(in thousands of U.S. dollars)

| | January 2, 2005 | October 3, 2004 | January 4, 2004 |
|---|---|---|---|
| | (unaudited) | (audited) | (unaudited) |
| Current assets: | | | |
| Cash and cash equivalents | $ 52,381 | $ 60,671 | $ 37,490 |
| Accounts receivable | 49,099 | 85,317 | 45,760 |
| Inventories | 142,376 | 116,615 | 139,248 |
| Prepaid expenses and deposits | 5,872 | 3,243 | 4,923 |
| Future income taxes | 8,818 | 8,149 | 6,049 |
| | 258,546 | 273,995 | 233,470 |
| Fixed assets | 234,992 | 211,693 | 190,295 |
| Other assets | 3,739 | 3,127 | 3,520 |
| Total assets | $ 497,277 | $ 488,815 | $ 427,285 |

Current liabilities: Accounts payable and accrued liabilities $ 65,363 $ 74,607 $ 56,599 Income taxes payable 2,364 1,966 4,016 Current portion of long-term debt 19,711 18,610 19,409

87,438 95,183 80,024 Long-term debt 41,153 37,979 57,198 Future income taxes 29,235 28,058 22,725 Non-controlling interest 2,860 — — Shareholders' equity: Share capital (note 3) 78,579 78,170 75,753 Contributed surplus 881 681 220 Retained earnings 230,883 222,496 165,117 Cumulative translation adjustment 26,248 26,248 26,248

336,591 327,595 267,338

Total liabilities and shareholders' equity $ 497,277 $ 488,815 $ 427,285

See accompanying notes to interim consolidated financial statements.

Gildan Activewear Inc.

Consolidated Statements of Earnings

(In thousands of U.S. dollars, except per share data)

Three months ended

January 2, 2005 January 4, 2004 (unaudited) (unaudited) Sales $108,957 $77,959 Cost of sales 76,577 56,859

Gross profit 32,380 21,100 Selling, general and administrative expenses 16,327 11,397

Earnings before interest, income taxes, depreciation and amortization 16,053 9,703 Depreciation and amortization 5,880 4,932 Interest expense 1,201 1,589

Earnings before income taxes 8,972 3,182 Income taxes 585 310

Net earnings $ 8,387 $ 2,872

Basic EPS (note 4) $ 0.28 $ 0.10 Diluted EPS (note 4) $ 0.28 $ 0.10

Consolidated Statements of Retained Earnings

(In thousands of U.S. dollars)

Three months ended

| | January 2, 2005 (unaudited) | January 4, 2004 (unaudited) |
|---|---|---|
| Retained earnings, beginning of the period | $ 222,496 | $ 162,245 |
| Net earnings | 8,387 | 2,872 |
| Retained earnings, end of the period | $ 230,883 | $ 165,117 |

See accompanying notes to interim consolidated financial statements.

# Gildan Activewear Inc.

Consolidated Statements of Cash Flows
(In thousands of U.S. dollars)

| | Three months ended | |
|---|---|---|
| | January 2, 2005 (unaudited) | January 4, 2004 (unaudited) |
| Cash flows from operating activities: | | |
| Net earnings | $ 8,387 | $ 2,872 |
| Adjustments for: | | |
| Depreciation and amortization | 5,880 | 4,932 |
| Stock based compensation | 200 | — |
| Future income taxes | (183 ) | 122 |
| Loss on disposal of fixed assets | 325 | 40 |
| Unrealized foreign exchange gain | (159 ) | (33 ) |
| | 14,450 | 7,933 |
| Net changes in non-cash working capital balances: | | |
| Accounts receivable | 37,701 | 19,201 |
| Inventories | (25,305 ) | (35,745 ) |
| Prepaid expenses and deposits | (2,560 ) | (1,242 ) |
| Accounts payable and accrued liabilities | (12,286 ) | (9,854 ) |
| Income taxes payable | 236 | 21 |
| | 12,236 | (19,686 ) |
| Cash flows from financing activities: | | |
| Repayment of capital leases and other long-term debt | (375 ) | (1,171 ) |
| Increase in long-term debt | 1,281 | 4,125 |
| Proceeds from the issuance of shares | 409 | 263 |
| | 1,315 | 3,217 |
| Cash flows from investing activities: | | |
| Purchase of fixed assets, net of disposals | (22,089 ) | (16,123 ) |
| (Increase) decrease in other assets | (54 ) | 19 |
| | (22,143 ) | (16,104 ) |
| Effect of exchange rate changes on cash and cash equivalents | 302 | 723 |
| Net decrease in cash and cash equivalents during the period | (8,290 ) | (31,850 ) |
| Cash and cash equivalents, beginning of period | $ 60,671 | $ 69,340 |
| Cash and cash equivalents, end of period | $ 52,381 | $ 37,490 |

See accompanying notes to interim consolidated financial statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(For the period ended January 2, 2005)
(Tabular amounts in thousands of U.S. dollars, except per share data)
(unaudited)

1. Basis of presentation:

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the Canadian generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by Canadian generally accepted accounting principles for complete financial statements, and should be read in conjunction with the Company's annual consolidated financial statements. The January 2, 2005 unaudited interim consolidated financial statements include the full consolidation of Cedartown Manufacturing LLC ("Cedartown"), the Company's 50% owned joint venture with Frontier Spinning Mills, Inc. Historically, the Company has accounted for its investment in Cedartown using the proportionate consolidation method (see Note 2, Significant account policies below).

The Company's revenues and income are subject to seasonal variations. Consequently, the results of operations for the first quarter ended January 2, 2005 are traditionally not indicative of the results to be expected for the full year.

Certain comparative figures have been reclassified in order to conform with the current's year's presentation.

All amounts in the attached notes are unaudited unless specifically identified.

2. Significant accounting policies:

The Company applied the same accounting policies in the preparation of the interim consolidated financial statements, as disclosed in Note 2 of its audited consolidated financial statements in the Company's annual report for the year ended October 3, 2004, except as noted below.

The following policy has been applied for the first time in this quarter following a new Accounting Guideline issued by the Canadian Institute of Chartered Accountants ("CICA");

Variable interest entities (AcG-15)

The CICA issued a guideline on accounting for variable interest entities ("VIEs") titled Accounting Guideline 15 – Consolidation of Variable Interest Entities ("AcG-15"), which proposes guidelines to harmonize with corresponding guidance in the United States. A VIE is any type of legal structure not controlled by voting equity but rather by/or through contractual or other financial arrangements. This guideline requires the Company to identify VIEs in which it has an interest, determine whether it is the primary beneficiary of such entities and, if so, to consolidate the VIE. A primary beneficiary is an enterprise that will absorb a majority of the VIE's expected losses, receive a majority of its expected residual return, or both. We have determined that the Company's joint venture with Frontier Spinning Mills, Inc. (Cedartown Manufacturing LLC) meets the criteria for being a VIE and that the
Company is the primary beneficiary of the entity.

The Company elected to early adopt this standard on October 4, 2004, the beginning of its 2005 fiscal year, in order to minimize any potential difference between Canadian and U.S. GAAP. The consolidation of Cedartown at October 4, 2004, the beginning of the Company's 2004 fiscal year, increased total assets by $7.9 million and total liabilities by $5.0 million, while creating a non-controlling interest of $2.9 million. The Company's net earnings will not be affected by this change.

The consolidation of the Company's interest in Cedartown did not result in any material change in the underlying tax, legal or credit risks facing the Company.

3. Share capital:

| | Three months ended | | | |
|---|---|---|---|---|
| | January 2, 2005 | | January 4, 2004 | |
| | Shares | Book Value | Shares | Book Value |
| Authorized without limit as to number and without par value: | | | | |
| First preferred shares, issuable in series, non-voting | | | | |
| Second preferred shares, issuable in series, non-voting | | | | |
| Class A subordinate voting shares, participating, one vote per share | | | | |
| Class B multiple voting shares, participating, eight votes per share | | | | |
| Issued and outstanding: | | | | |
| Class A subordinate voting shares: | | | | |
| Total outstanding, beginning of period | 29,699 | $78,170 | 23,426 | $72,023 |
| Shares issued under employee share purchase plan | 1 | 33 | 2 | 47 |
| Shares issued pursuant to exercise of stock options | 19 | 376 | 15 | 216 |
| Total outstanding, end of period | 29,719 | 78,579 | 23,443 | 72,286 |
| Class B multiple voting shares | 0 | 0 | 6,094 | 3,467 |
| | 29,719 | $78,579 | 29,537 | $75,753 |

The Company has obtained approval from the Toronto Stock Exchange to renew the stock repurchase program authorizing the Company to purchase up to a maximum of 500,000 of the Company’s Class A subordinate voting shares in the open market commencing December 22, 2004 and ending December 21, 2005. As at January 2, 2005 no shares have been repurchased under this plan.

At the annual and special meeting of the shareholders on February 2, 2005, our shareholders approved a special resolution to amend our Articles of Incorporation in order to change each of the issued and outstanding Class A subordinate voting shares into one newly-created common share and to remove the Class B multiple voting shares and the Class A subordinate voting shares, effectively eliminating our dual class voting structure.

On December 1, 2004, our Board of Directors adopted a shareholder rights plan, which became effective that same day. At the annual and special meeting of the shareholders on February 2, 2005, our shareholders approved a resolution confirming the ratification of the shareholder rights plan. The objectives of the shareholder rights plan are to provide the Board of Directors and the shareholders with adequate time to assess any unsolicited take-over bid for the Company and where appropriate, give the Board of Directors sufficient time to pursue other alternatives for maximizing shareholder value. The shareholder rights plan was not adopted in response to any specific proposal to acquire control of the Company nor is the Board of Directors currently aware of any pending or threatened take-over bid for the Company.

On March 1, 2004, the holders of the Class B multiple voting shares converted all their issued and outstanding shares into Class A subordinate voting shares on a one-for-one basis for no consideration.

4. Earnings per share:

The following table sets forth the computation of basic and diluted earnings per share:

| | Three months ended | |
|---|---|---|
| | January 2, 2005 | January 4, 2004 |
| Basic earnings per share: | | |
| Basic weighted average number of common shares outstanding | 29,704 | 29,524 |
| Basic earnings per share | $ 0.28 | $ 0.10 |
| Diluted earnings per share: | | |
| Basic weighted average number of common shares outstanding | 29,704 | 29,524 |
| Plus impact of stock options | 181 | 268 |
| Diluted weighted average number of common shares outstanding | 29,885 | 29,792 |
| Diluted earnings per share | $ 0.28 | $ 0.10 |

Stock-Based Compensation and Other Stock-Based Payments:
Effective the commencement of our 2004 fiscal year, the Company follows the fair value-based method to account for all transactions whereby goods and services are received in exchange for stock-based compensation and other stock-based payments. Under the fair value method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting periods. The following disclosure is required to report the pro forma net earnings and earnings per share as if the fair value-based method had been used to account for employee stock options granted during fiscal 2003.

| | Three months ended | |
|---|---|---|
| | January 2, 2005 | January 4, 2004 |

Net earnings, as reported 8,387 2,872 Deduct: Total stock-based employee compensation expense determined under fair value based method for all wards granted in fiscal 2003 26 83

Pro forma net earnings $ 8,361 $ 2,789

Earnings per share: Basic: As reported $ 0.28 $ 0.10 Pro forma 0.28 0.09 Diluted: As reported 0.28 0.10 Pro forma 0.28 0.09

The weighted average fair value of the remaining 34,329 options granted in fiscal 2003 is CAD $10.86 per, which is recognized over the vesting period for purposes of calculating pro forma net earnings. As at January 4, 2004, there were 121,206 of the options granted in fiscal 2003 outstanding having a weighted average fair value of CAD $10.65 per share. The Company only accounts for forfeitures as they occur. The weighted average fair value of the stock options granted during fiscal 2003 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: expected dividend yield of nil; expected volatility of 34.94%; risk-free interest rate of 3.63%; and expected lives of 3 years.

5. Guarantees:

Significant guarantees that have been provided to third parties are the following:

The Company, including certain of its subsidiaries, have granted irrevocable standby letters of credit and surety bonds, issued by highly rated financial institutions, to third parties to indemnify them in the event the Company does not perform its contractual obligations. As at January 2, 2005, the maximum potential liability under these guarantees was $24.9 million of which $8.7 million was surety bonds and $16.2 million was for standby letters of credit and corporate guarantees. The standby letters of credit mature at various dates during 2005 and the surety bonds are automatically renewed on an annual basis.

As at January 2, 2005, the Company has not recorded a liability with respect to these guarantees, as the Company does not expect to make any payments for the aforementioned items.

6. Financial instruments:

The following table summarizes the Company’s commitments to buy and sell foreign currencies as at January 2, 2005 and January 4, 2004:

Notional amount
Exchange rate
Maturity

Notional U.S. equivalent

| | | | | | | |
|---|---|---|---|---|---|---|
| 2005: | Buy contracts: | Foreign exchange contracts | CAD$ 42,840 | 0.7251 to 0.7896 | January to September 2005 | $32,573 |
| | Sell contracts: | Foreign exchange contracts | £ 5,435 | 1.8815 to 1.9197 | January 2005 to March 2006 | $10,317 |
| | | | € 19,259 | 1.3308 to 1.3721 | January 2005 to March 2006 | $26,085 |
| 2004: | Sell contracts: | Foreign exchange contracts | £ 10,200 | 1.1740 to 1.2202 | January to October 2004 | $12,148 |
| | | | € 5,390 | 1.6660 to 1.6850 | January to October 2004 | $ 9,010 |

7. Segmented information:

The Company manufactures and sells activewear apparel. The Company operates in one business segment.

For the three-month period ended January 2, 2005 and January 4, 2004 the Company had one individual customer who accounted for 36.4% and 22.5% of total sales, respectively.

Sales were derived from customers located in the following geographic areas:

| | Three months ended | |
|---|---|---|
| | January 2, 2005 | January 4, 2004 |
| United States | $ 95,571 | $66,775 |
| Canada | 6,820 | 6,459 |
| Europe and other | 6,566 | 4,725 |
| | $108,957 | $77,959 |

Fixed assets by geographic areas are as follows:

| | January 2, 2005 | October 3, 2004 (audited) | January 4, 2004 |
|---|---|---|---|
| Canada | $ 79,711 | $ 82,034 | $ 91,695 |
| Caribbean basin, Central America and Mexico | 114,170 | 101,653 | 74,322 |
| United States | 41,111 | 28,006 | 24,278 |
| | $234,992 | $211,693 | $190,295 |

8. Other information:

(a) The following items were included in the determination of the Company's net earnings:

| | Three months ended | |
|---|---|---|
| | January 2, 2005 | January 4, 2004 |
| Depreciation expense of fixed assets | $ 5,684 | $ 4,755 |
| Interest expense on long-term debt | 1,319 | 1,589 |
| Foreign exchange (gain) loss | (604 ) | 761 |
| Amortization expense of deferred start-up costs | 87 | 79 |
| Amortization of deferred financing costs and other | 110 | 97 |
| Investment income | (119 ) | (134) |

(b) Supplemental cash flow disclosure:

| | | |
|---|---|---|
| Cash paid during the period for: | | |
| Interest | 1,237 | 1,579 |
| Income taxes | 82 | 86 |
| Non-cash transactions: | | |
| Additions of fixed assets included in accounts payable | 3,997 | 968 |
| Cash and cash equivalents consist of: | | |
| Cash balances with banks | $29,581 | $24,649 |
| Short-term investments | 22,800 | 12,841 |
| | $52,381 | $37,490 |

9. Subsequent event:

The Company announced on February 1, 2005 that it will close its two Canadian yarn-spinning operations at the end of March 2005. A majority of the equipment will be transferred to a new yarn-spinning facility in Clarkton, North Carolina, which will be operated by the Company's yarn-spinning joint-venture with Frontier Spinning Mills Inc. The Company anticipates that the closure costs will be approximately $7.8 million after tax or $0.26 per diluted share. The closure costs will consist mainly of severance and the loss on disposal of fixed assets that are not being transferred. This charge will be expensed in the second quarter of fiscal 2005.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND OPERATING RESULTS

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto for the three months ended January 2, 2005, and with Management's Discussion and Analysis of Financial Condition and Results of Operations ("2004 MD&A") in the fiscal 2004 Annual Report, including the sections on critical accounting estimates and risks.

All financial information contained in this Interim MD&A and the Interim Company’s Consolidated Financial Statements has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), except for certain information discussed in the paragraph entitled Non-GAAP Financial Measures on page 19 of this Interim MD&A. The Company’s financial results are reconciled to U.S. GAAP at the end of its fiscal year. The effect of significant differences between Canadian and U.S. GAAP is discussed in Note 16 to the Company’s 2004 Consolidated Financial Statements. All amounts in this report are in U.S. dollars, unless otherwise stated. Gildan Activewear’s Audit and Finance Committee and its Board of Directors have reviewed this MD&A to ensure consistency with the approved strategy of the Company.

For additional information relating to the Company, readers may review the documentation filed by the Company with the Canadian securities regulatory authorities (including the Company’s Annual Information Form) available at www.sedar.com and with the U.S. Securities and Exchange Commission (including the Annual Report on 40-F) available at www.sec.gov.

CORPORATE OVERVIEW

We are a rapidly growing, vertically-integrated manufacturer and marketer of premium quality basic activewear for sale principally into the wholesale imprinted activewear market in the Canadian, United States, European and other international apparel markets. Our sales continue to be predominately in our historical markets in the United States and Canada. During the past four years we established a strong base for future growth in Europe, where, as of January 2005, we had set up a network of 36 distributors in 20 countries. We entered the Australian market in fiscal 2004. We manufacture and sell premium quality T-shirts, placket collar sport shirts and fleece products in a variety of weights, sizes, colors and styles. We sell our products as “blanks”, which are ultimately decorated with designs and logos for sale to customers.

To support its sales in the various markets, the Company has modern textile facilities located in Canada and Honduras. The Company is currently constructing textile facilities in both the Dominican Republic and Nicaragua, which are scheduled for start-up in fiscal 2005. All of the Company’s sewing facilities are located in Central America, Mexico and the Caribbean basin. Due to the growing demand for its products, the Company also utilizes third party contractors to complement its vertically-integrated production.

The Company distributes its products in Canada and the U.S. out of distribution centres, and uses third party warehouses in Europe and Australia to service its international customers. The corporate head office is located in Montreal, Canada and over 8,000 full-time employees work in the Company’s facilities worldwide.

<u>Results of Operations</u>

Sales

Sales for the three months ended January 2, 2005 were $109.0 million, up 39.8% from $78.0 million for the three months ended January 4, 2004. The significant growth in sales revenues was due to improved selling prices, a 27.5% increase in unit sales volumes, and a higher-valued product-mix within the T-shirt category.

The S.T.A.R.S. market and market share data for the U.S. wholesale distributor market for the fourth quarter of calendar 2004 excludes sales by three large distributors who have discontinued their participation in the report and the value of the report is therefore reduced compared to prior years. With this caveat, the table below summarizes the S.T.A.R.S. data for the quarter ended December 31, 2004. In calculating year-over-year growth rates, S.T.A.R.S. has adjusted prior period comparatives to exclude sales through distributors no longer participating in the S.T.A.R.S. report. Although prior year market share data have not been restated on a comparable basis by S.T.A.R.S., this information has been extrapolated from the information provided in the S.T.A.R.S. report.

| | Gildan Market Share Q1 2004 | Gildan Market Share Q1 2005 | Gildan Unit growth Q1 2005 vs Q1 2004 | Industry Unit growth Q1 2005 vs Q1 2004 |
|---|---|---|---|---|
| T-shirts | 26.9 % | 30.2 % | 13.5 % | 1.1 % |
| Sport shirts | 20.9 % | 24.6 % | 18.6 % | 0.8 % |
| Fleece | 13.5 % | 18.6 % | 56.2 % | 12.9 % |

During the first quarter of fiscal 2005, Gildan also experienced strong growth with non-S.T.A.R.S. distributors.

During the first quarter of fiscal 2005 the Company continued to expand its European business, with an increase of 15.3% in unit sales. We continue to expect to achieve our forecasted growth in Europe and Australia in fiscal 2005. The Company has maintained its leading market share position in Canada.

Gross Margin

Gross margin increased from 27.1% in the first quarter of fiscal 2004 to 29.7% for the first quarter of fiscal 2005. Before the impact of the functional currency adjustment on cost of sales in the first quarter of last year, comparative gross margins were 29.8%. The positive gross margin impact of higher selling prices and more favourable product-mix was offset by higher cotton, energy and transportation costs and higher costs for the Canadian yarn-spinning operations.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $16.3 million or 15.0% of sales for the first quarter of fiscal 2005, compared to $11.4 million or 14.6% of sales in the first quarter of fiscal 2004. In addition to reflecting the continuing development of the organization to manage the Company's growth and expansion plans, SG&A increased due to the strengthening of the Canadian dollar, the timing of professional and consulting fees and increased volume-related selling and distribution costs. As a percentage of sales, these expenses are higher in the first quarter of the fiscal year due to the seasonality of the business. The Company expects that for fiscal 2005, SG&A expenses will be at a similar level as a percentage of sales as fiscal 2004.

Depreciation and Interest Expense
Depreciation expense increased from $4.9 million in the first quarter of fiscal 2004 to $5.9 million in the first quarter of fiscal 2005. The increase in depreciation expense is the result of the Company's continued investment in capital expenditures to provide for long-term sales growth.

Interest expense has decreased to $1.2 million in the first quarter of fiscal 2005 from $1.6 million in the first quarter of fiscal 2004. The decrease is the result of the reduction in overall debt following the first scheduled principal repayment made in June 2004 on the Company’s U.S. Senior Notes.

Income taxes
The income tax rate for the first quarter of fiscal 2005 was 6.5% compared to 9.7% for the first quarter of the prior fiscal year. The Company continues to anticipate that the effective tax rate will range between 5%-6% for fiscal 2005 as sales continue to grow in its international operations and are increasingly sourced from its offshore textile facilities.

Earnings
Net earnings were $8.4 million or $0.28 per share on a diluted basis in the first quarter of fiscal 2005 compared to $2.9 million or $0.10 per share on a diluted basis in the first quarter of fiscal 2004. Excluding the impact of the change to the U.S. dollar functional currency, net earnings were $5.0 million or $0.17 per share on a diluted basis for the first quarter of fiscal 2005.

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Compared to last year, the increase in first quarter net earnings was driven by higher selling prices and continuing growth in unit sales volumes, together with more favourable product-mix. These positive factors were partially offset by higher SG&A expenses, increased raw material costs and the impact of lower capacity utilization on the efficiency of the Canadian yarn-spinning operations.

Balance Sheet

Accounts receivable decreased to $49.1 million in the first quarter of fiscal 2005 from $85.3 million at October 3, 2004 and increased by $3.3 million compared to the first quarter of the prior year. The reduction in receivables compared with October 3, 2004 was due to lower seasonal sales combined with a reduction in days sales outstanding on trade accounts receivable. The increase in accounts receivable from the first quarter of fiscal 2004 is due to the 39.8% increase in sales over the prior year offset by a reduction in days sales outstanding. Inventories have increased by $25.8 million from October 3, 2004 and by $3.1 million from the first quarter of fiscal 2004 to $142.4 million in the first quarter of fiscal 2005. The Company traditionally builds up inventory levels in the first quarter to meet peak sales demand in the summer. The build up in the current year is in line with the Company’s sales forecast.

In the first quarter of fiscal 2005, the Company invested $22.1 million in fixed assets mainly for the textile facilities in the Dominican Republic and Honduras along with the expansion of our U.S. distribution centre to prepare for entry into the retail channel. In the first quarter of fiscal 2004, the Company invested $16.1 million in fixed assets.

Liquidity and Capital Resources
The Company has in recent years funded its capital requirements with cash generated from operations. A revolving credit facility has been periodically utilized to finance seasonal peak working capital requirements. The Company’s primary uses of financing on an ongoing basis are related to capital expenditures for new manufacturing facilities, inventory financing, accounts receivable funding, servicing the interest payments on our U.S. Senior Notes as well as scheduled annual repayments of principal over the next three years.

As a result of the seasonal nature of the apparel business, working capital requirements are variable throughout the year. For the quarter ended January 2, 2005, cash inflows from operating activities, including changes in non-cash working capital balances, amounted to $12.2 million compared with a use of cash of $19.7 million during the same period last year. The increase in cash inflow was mainly due a reduction in days sales outstanding and a smaller build up of seasonal inventory in the first quarter of fiscal 2005. The Company’s need for working capital typically grows throughout the first two quarters as inventories are built up for the peak selling period in the third quarter.

At January 2, 2005, none of the Company's revolving bank facility was utilized. Total indebtedness[1] at January 2, 2005, amounted to $60.9 million compared to $56.6 million at October 3, 2004 and $76.6 million at January 4, 2004.

Continued sales growth in fiscal 2005 will result in increased working capital requirements mainly to finance trade accounts receivable and inventory. For fiscal 2005, the Company estimates to spend between $85 million to $90 million on capital expenditures. The Company expects to continue to have sufficient liquidity and capital resources throughout 2005 to fund its working capital requirements, capital expenditures and the June 2005 repayment on its U.S. Senior Notes.

Total assets were $497.3 million at January 2, 2005 compared to $488.8 million at October 3, 2004 and $427.3 million at January 4, 2004. Working capital was $171.1 million at the end of the first quarter of fiscal 2005 compared to $178.8 million at October 3, 2004, and $153.4 million at January 4, 2004.

1 Total long-term debt. See Non-GAAP Financial Measure on page 19.

Off-Balance Sheet Arrangements

Operating Leases

We have no commitments that are not reflected in our balance sheets except for operating leases and other purchase obligations, which are included in the table of contractual obligations below. As disclosed in Note 5 to our Interim Consolidated Financial Statements, we have issued standby letters of credit and corporate guarantees primarily from various servicing agreements amounting to $16.2 million at January 2, 2005.

Derivative Financial Instruments

From time to time, the Company uses forward foreign exchange contracts, primarily in Canadian dollars and Euros, to hedge cash flows related to sales and disbursements in foreign currencies (non-U.S. dollar). A forward foreign exchange contract represents an obligation to exchange a foreign currency with a counterparty at a predetermined rate. Credit risk exists in the event of failure by a counterparty to meet its obligations. The Company reduces this risk by dealing only with highly rated counterparties, normally major North American financial institutions. The Company's exposure to foreign currency fluctuations is described in more detail in the "Risks" section of the 2004 MD&A.

The Company does not use derivative financial instruments for speculative purposes. Forward foreign exchange contracts are entered into with maturities not exceeding twenty-four months.

The following table summarizes the Company's commitments to buy and sell foreign currencies as at January 2, 2005 and January 4, 2004:

| | | | Notional amount | Exchange rate | Maturity | Notional U.S. equivalent |
|---|---|---|---|---|---|---|
| 2005: | Buy contracts: | Foreign exchange contracts | CAD$ 42,840 | 0.7251 to 0.7896 | January to September 2005 | $32,573 |
| | Sell contracts: | | | | | |
| | | Foreign exchange contracts | £ 5,435 | | | |

1.8815 to 1.9197
January 2005 to March 2006
$10,317

€ 19,259

1.3308 to 1.3721
January 2005 to March 2006

$26,085 2004: Sell contracts: Foreign exchange contracts £ 10,200

1.1740 to 1.2202
January to October 2004
$12,148

€ 5,390

1.6660 to 1.6850
January to October 2004
$ 9,010

Contractual Obligations

In the normal course of business, the Company enters into contractual obligations that will require it to disburse cash over future periods. The following table sets forth the Company's contractual obligations for the following items as at January 2, 2005:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| (in millions) | Total | Less than 1 year | 1 – 3 years | 4 – 5 years | After 5 years |
| Long Term Debt | $ 60 .7 | $ 19 .2 | $ 39 .2 | $ 2 .3 | — |
| Capital Lease Obligations | 0 .3 | 0 .1 | 0 .2 | — | — |
| Operating Leases | 8 .3 | 2 .0 | 3 .3 | 1 .8 | 1 .2 |
| Purchase Obligations | 122 .3 | 109 .9 | 12 .4 | — | — |

| | | | | | |
|---|---|---|---|---|---|
| Other Long Term | | | | | |
| Obligations | 68 .9 | 64 .1 | 4 .8 | — | — |
| Total Contractual | | | | | |
| Obligations | $ 260 .5 | $ 195 .3 | $ 59 .9 | $ 4 .1 | $ 1 .2 |

Management expects that cash flow from its operating earnings, together with its year-end cash balances and unutilized bank facilities, will be sufficient to meet foreseeable cash needs for fiscal 2005.

Summary of Quarterly Results

The following table sets forth certain summarized unaudited quarterly financial and other data for the periods presented. The financial data have been derived from the Company's unaudited financial statements that, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such quarterly data. The operating results for any quarter are not necessarily indicative of the results to be expected for any future period.

| (in millions, except per share data) | 2005 Q1 |
|---|---|
| Unit sales (Dozen) | 5.1 |
| Sales | $ 109.0 |
| Net earnings | 8.4 |
| Basic EPS | 0.28 |
| Diluted EPS | 0.28 |
| Total assets | 497.3 |
| Total long-term financial liabilities | $ 73.2 |
| Weighted average # of shares outstanding (in thousands) | |
| Basic | 29,704 |
| Diluted | 29,885 |

| (in millions, except per share data) | 2004 |
|---|---|
| | Q1 |
| | Q2 |

Q3

Q4

Unit sales (Dozen) 4.0 7.6 8.4 6.9 Sales $ 78.0 $ 141.4 $ 168.4 $ 145.6 Net earnings 2.9 14.3 26.2 16.8 Basic EPS 0.10 0.48 0.89 0.57 Diluted EPS 0.10 0.48 0.88 0.56

Total assets 427.3 447.6 457.3 488.8 Total long-term financial liabilities $ 79.9 $ 81.2

$ 60.9

$ 66.0

Weighted average # of shares outstanding (in thousands)

Basic 29,524 29,576 29,628 29,635 SE:COLLAPSE" BORDER="0" CELLPADDING="0" CELLSPACING="0" WIDTH="100%">

Governance and Nominating Committee 4

Safety Committee 5

In the aggregate, each director attended, on average, at least 97% of all Board and applicable committee meetings during 2008. Each director is expected to attend the Company s Annual Meeting of Stockholders. Last year, all then-current directors attended the 2008 annual meeting.

### Board and Committee Independence

The Board of Directors of the Company has determined that all of the directors except Mr. Ayer, which includes each member of the Audit Committee, Governance and Nominating Committee, and Compensation Committee, are independent under the NYSE listing standards and the Company s independent director standards that are set forth in the Company s Corporate Governance Guidelines. In making its determination, the Board of Directors considered the amount of charitable contributions made by the Company to certain charitable organizations on which Ms. Bedient serves as director and the amount of a charitable contribution made by the

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Company to the University of Alaska where Mr. Hamilton is currently employed as President. After consideration of these matters and in accordance with the Board s independent director criteria, the Board of Directors affirmatively determined that none of these matters is a material relationship with the Company because the amount of the contributions were immaterial with respect to the Company s and the charitable organizations annual revenues.

Each member of the Company s Audit Committee meets the additional independence, financial literacy and experience requirements contained in the corporate governance listing standards of the NYSE relating to audit committees or required by the SEC. The Board has determined that Ms. Bedient is an audit committee financial expert as defined in SEC rules.

The Corporate Governance Guidelines are available on the Company s internet website at http://www.alaskaair.com and are available in print to any stockholder who submits a written request to the Company s Corporate Secretary. Specifically, the Board has determined that independent directors meet the following criteria:

An independent director must have no material relationship with the Company, based on all material facts and circumstances. At a minimum, an independent director must meet each of the categorical standards listed below.

1. The director has not, within the last three years, been employed by and no immediate family member has been an executive officer of the Company.

2. Neither the director nor any immediate family member has, in any 12-month period in the last three years, received more than $100,000 in direct compensation from the Company, other than compensation for director or committee service and pension or other deferred compensation for prior service.

3. (i) Neither the director nor any immediate family member is a current partner of the Company s independent auditor; (ii) the director is not a current employee of the audit firm; (iii) no immediate family member is a current employee of the audit firm working in its audit, assurance or tax compliance practice; and (iv) neither the director nor any immediate family member was an employee or partner of the audit firm within the last three years and worked on the Company s audit within that time.

4. Neither the director nor any immediate family member has, within the last three years, been part of an interlocking directorate. This means that no executive officer of the Company serves on the compensation committee of a company that employs the director or immediate family member.

5. The director is not currently an employee, and no immediate family member is an executive officer, of another company (i) that represented at least 2% or $1 million, whichever is greater, of the Company s gross revenues, or (ii) of which the Company represented at least 2% or $1 million, whichever is greater, of such other company s gross revenues, in any of the last three fiscal years. Charitable contributions are excluded from this calculation.

The Board considers that the following situations do not create material relationships:

a. the receipt by a director of retirement compensation earned under one or more tax-qualified or nonqualified plans during the director s employment with the Company;

b. ordinary-course business between the Company and an organization of which the Board member is an officer or director, where the amount of such business is immaterial with respect to the Company s or the organization s annual revenues; or

c. the receipt of cash or in-kind contributions from the Company by a tax-exempt charitable organization of which the Board member is an officer or director, the value of which is immaterial with respect to the Company s or the charitable organization s annual revenues.

For the purposes of these standards, Company includes all Alaska Air Group

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subsidiaries and other affiliates. Immediate family member includes the director s spouse, domestic partner, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, and anyone sharing the director s home. The independence standards for the members of the Audit Committee provide that in addition to the foregoing standards they may not (a) receive any compensation other than director s fees for Board and Audit Committee service and permitted retirement pay, or (b) be an affiliate of the Company as defined by applicable SEC rules.

## Director Nomination Policy

### *Identification and Evaluation of Candidates*

1. Internal Process for Identifying Candidates

The Governance and Nominating Committee (the Committee ) has two primary methods for identifying candidates (other than those proposed by the Company s stockholders, as discussed below). First, on a periodic basis, the Committee solicits ideas for possible candidates from a number of sources including, but not limited to, members of the Board, senior-level Company executives, individuals personally known to the members of the Board, and research, including database and internet searches.

Additionally, the Committee may, from time to time, use its authority under its charter to retain at the Company s expense one or more search firms to identify candidates (and to approve any such firms fees and other retention terms). If the Committee retains one or more search firms, those firms may be asked to identify possible candidates who meet the minimum and desired qualifications established by the Committee and to undertake such other duties as the Committee may direct.

2. Candidates Proposed by Stockholders

a. General Nomination Right of All Stockholders

Any stockholder of the Company may nominate one or more persons for election as a director of the Company at an annual meeting of stockholders if the stockholder complies with the notice, information and consent provisions contained in Article II, Section 8 of the Company s Bylaws. Specifically, these provisions require that written notice of a stockholder s intent to make a nomination for the election of directors be received by the Secretary of the Company at least 90 days in advance of the third Tuesday in May (with respect to elections held at a regular annual meeting of stockholders), and that such notice include:

- The name and address of the stockholder who intends to make the nomination and of the person(s) to be nominated;
- A representation that the stockholder of record is entitled to vote at the meeting;
- A description of all arrangements or understandings between the stockholder and each nominee and any other person(s) (naming them) pursuant to which the nomination is to be made;
- Other information regarding each nominee as would have been required to be included in a proxy statement filed pursuant to the proxy rules of the SEC had each nominee been nominated by the Board of Directors; and
- The consent of each nominee to serve as a director if elected.

The Corporate Secretary and General Counsel will send a copy of the Company s Bylaws to any interested stockholder who requests them. The Company s Bylaws are also available on the Company s website at http://www.alaskaair.com.

b. Consideration of Director Candidates Recommended by Stockholders

The Committee will evaluate candidates recommended by a single stockholder, or group of stockholders, that has beneficially owned more than 5% of the Company  s outstanding common stock for at least one year and that satisfies the notice, information and consent provisions set forth below (such individual or

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group is referred to as the Qualified Stockholder ). The Committee s policy on the evaluation of candidates recommended by stockholders who are not Qualified Stockholders is to evaluate such recommendations, and establish procedures for such evaluations, on a case-by-case basis. This policy allows the Committee to devote an appropriate amount of its own and the Company s resources to each such recommendation, depending on the nature of the recommendation itself and any supporting materials provided. In addition, as discussed above, non-Qualified Stockholders have the ability to nominate one or more director candidates directly at the annual meeting. All candidates (whether identified internally or by a stockholder) who, after evaluation, are then recommended by the Committee and approved by the Board, will be included in the Company s recommended slate of director nominees in its proxy statement.

c. Initial Consideration of Candidates Recommended by Qualified Stockholders

The Committee will evaluate candidates recommended by Qualified Stockholders in accordance with the following procedures.

Qualified Stockholders may propose a candidate for evaluation by the Committee by delivering a written notice to the Committee satisfying each of the requirements described below (the Notice ). The Notice must be received by the Committee not less than 120 calendar days before the anniversary of the date that the Company s proxy statement was released to stockholders in connection with the previous year s annual meeting. No such notice was received in connection with the 2009 Annual Meeting.

Any candidate recommended by a Qualified Stockholder must be independent of the Qualified Stockholder in all respects (i.e., free of any material personal, professional, financial or business relationships from the nominating stockholder), as determined by the Committee or by applicable law. Any candidate submitted by a Qualified Stockholder must also meet the definition of an independent director under applicable NYSE rules.

The Notice shall also contain or be accompanied by the following information or documentation:

Proof of the required stock ownership (including the required holding period) of the stockholder or group of stockholders. The Committee may determine whether the required stock ownership condition has been satisfied for any stockholder that is the stockholder of record. Any stockholder that is not the stockholder of record must submit such evidence as the Committee deems reasonable to evidence the required ownership percentage and holding period.

A written statement that the stockholder intends to continue to own the required percentage of shares through the date of the annual meeting with respect to which the candidate is nominated.

The name or names of each stockholder submitting the proposal, the name of the candidate, and the written consent of each such stockholder and the candidate to be publicly identified.

Regarding the candidate, such person s name, age, business and residence address, principal occupation or employment, number of shares of the Company s stock beneficially owned, if any, a written resume or curriculum vitae of personal and professional experiences, and all other information relating to the candidate that would be required to be disclosed in a proxy statement or other filings required in connection with the solicitation of proxies for election of directors pursuant to Section 14 of the Securities Exchange Act of 1934, as amended, and the regulations promulgated thereunder (the Exchange Act ).

Regarding the candidate, information, documents or affidavits demonstrating to what extent the candidate meets the required minimum criteria, and the

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desirable qualities or skills, established by the Committee. The Notice must also include a written statement that the stockholder submitting the proposal and the candidate will make available to the Committee all information reasonably requested in furtherance of the Committee s evaluation of the candidate.

Regarding the stockholder submitting the proposal, the person s business address and contact information and any other information that would be required to be disclosed in a proxy statement or other filings required in connection with the solicitation of proxies for election of directors pursuant to Section 14 of the Exchange Act.

The signature of each candidate and of each stockholder submitting the proposal.

The Notice shall be delivered in writing by registered or certified first-class mail, postage prepaid, to the following address:

Board of Directors

Alaska Air Group, Inc.

PO Box 68947

Seattle, WA 98168

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## 2008 DIRECTOR COMPENSATION

The following table presents information regarding the compensation paid for 2008 to members of our Board of Directors who are not also our employees (referred to herein as Non-Employee Directors ). The compensation paid to Mr. Ayer, who is also one of our employees, is presented in the Summary Compensation Table and the related explanatory tables. Mr. Ayer does not receive additional compensation for his service as a director.

| Name (a) | Fees Earned or Paid in Cash ($)(1) (b) | Stock Awards ($)(2) (c) | Option Awards ($)(2) (d) | Non-Equity Incentive Plan Compensation ($)(2) (e) | Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(2) (f) | All Other Compensation ($)(3) (g) | Total ($) (h) |
|---|---|---|---|---|---|---|---|
| Patricia M. Bedient | 49,712 | 35,988 | 0 | 0 | 0 | 2,366 | 88,066 |
| Phyllis J. Campbell | 44,112 | 35,988 | 0 | 0 | 0 | 7,582 | 87,682 |
| Mark R. Hamilton | 42,262 | 35,988 | 0 | 0 | 0 | 12,702 | 90,952 |
| Jessie J. Knight, Jr. | 37,762 | 35,988 | 0 | 0 | 0 | 3,849(4) | 77,599 |
| R. Marc Langland | 41,262 | 35,988 | 0 | 0 | 0 | 13,288 | 90,538 |
| Dennis F. Madsen | 45,362 | 35,988 | 0 | 0 | 0 | 6,095 | 87,445 |
| Byron I. Mallott | 37,312 | 35,988 | 0 | 0 | 0 | 31,115 | 104,415 |
| J. Kenneth Thompson | 47,712 | 35,988 | 0 | 0 | 0 | 14,453 | 98,153 |

(1) Each of our non-employee directors received at least 70%, or $36,000, of their $51,000 annual retainer for 2008 in the form of deferred stock units issued under the Company s 2008 Performance Incentive Plan. Directors received No other equity-based awards were granted to our non-employee directors for 2008.

In 2009, in addition to the $51,000 annual retainer referenced above, the compensation for our non-employee directors included the following:

- attendance fees of $2,000 for each Audit Committee meeting and $1,200 per day for each Board or other committee meeting in which a non-employee director participated in person, or $750 if participation was via telephone;

- $500 for participation in telephone updates that occur between meetings;

- an annual retainer of $10,000 to the Governance and Nominating Committee chair, who is also the Lead Director;

- an annual retainer of $8,000 to the Audit Committee chair and $5,000 to Compensation and Safety Committee chairs;

- an annual retainer of $1,000 to non-employee directors who also served on the Boards of Directors of Alaska Airlines or Horizon Air;

- attendance fees of $1,500 to members of the Company s Finance Group; and reimbursement of expenses in connection with attending Board and committee meetings as well as expenses in connection with director education.

(2) Effective May 20, 2008, the stock portion of each non-employee director was paid in the form of deferred stock units under the 2008 Performance Incentive Plan, with the number of fully vested stock units determined by dividing $36,000 by the closing price of the Company s common stock on the date of the annual stockholders meeting. The stock units will be paid in shares of common stock on a one-for-one basis following the termination of the director s service as a member of the Board.

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As of December 31, 2008, non-employee directors each held 1,747 full vested deferred stock units.

Our directors do not participate in any non-equity incentive compensation plans, nor do they participate in a nonqualified deferred compensation plan. Directors do not receive pension benefits for their service.

(3) As part of a director s compensation, each Non-Employee Director, the Non-Employee Director s spouse and the Non-Employee Director s dependent children are provided transportation on Alaska Airlines and Horizon Air. Included in the All Other Compensation column for each non-employee director is the incremental cost to the Company of providing these benefits, as well as the value of each director s membership in our airport Boardroom program.

In addition, the All Other Compensation column includes the value of reimbursements for taxes on the transportation benefits provided to each director as quantified below:

| Director | Value of Taxes Paid ($) |
|---|---|
| Patricia M. Bedient | 2,091 |
| Phyllis J. Campbell | 7,307 |
| Mark R. Hamilton | 12,427 |
| Jessie J. Knight, Jr. | 3,574 |
| R. Marc Langland | 13,013 |
| Dennis F. Madsen | 5,820 |
| Byron I. Mallott | 30,840 |
| J. Kenneth Thompson | 14,178 |

(4) Amount reported for Mr. Knight includes California state tax reimbursement provided in connection with his transportation benefit.

## CEO AND CFO CERTIFICATIONS

In accordance with NYSE listing standards, the Company s 2008 CEO certification required by Section 303a.12(a) of the NYSE Listed Company Manual has been filed with the NYSE. In addition, the Company s CEO and CFO certifications required under Section 302 of the Sarbanes-Oxley Act are filed as exhibits to the Company s Annual Report on Form 10-K.

## CODE OF CONDUCT AND ETHICS

The Company has adopted a Code of Conduct and Ethics that applies to all employees of the Company, including our CEO, CFO, principal accounting officer and persons performing similar functions. The Code of Conduct and Ethics is located on the Company s internet website at http://www.alaskaair.com and is available in print to any stockholder who requests it. Information on the Company s website, however, does not form a part of this proxy statement. The Company intends to disclose any amendments (other than technical, administrative or non-substantive amendments) to, and any waivers from, a provision of the Code of Conduct and Ethics for directors or executive officers on the Company s internet website.

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## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Policies and Procedures for Approval of Related Person Transactions

Our Board of Directors has adopted a written policy for review, approval or ratification of any transaction, arrangement or relationship (i) in which we were, are or will be a participant, (ii) the aggregate amount involved exceeds $120,000 in any calendar year, and (iii) a related person has or will have a direct or indirect material interest (other than solely as a result of being a director or the beneficial owner of less than 10% of another entity). For purposes of the policy, a related person is (i) any person who is, or at any time since the beginning of our last fiscal year was, one of our directors or executive officers or a nominee to become a director, (ii) any beneficial owner of more than 5% of our common stock, or (iii) any immediate family member of any the these persons.

Under the policy, once a related person transaction has been identified, the Audit Committee (or the Chair of the Audit Committee for transactions that involve an aggregate amount of less than $1 million) must review the transaction for approval or ratification. Members of the Audit Committee or the Chair of the Audit Committee, as applicable, will review all relevant facts regarding the transaction in determining whether to approve or ratify it, including the extent of the related person s interest in the transaction, whether the terms are comparable to those generally available in arms length transactions, and whether the transaction is consistent with the best interests of the Company. The related person involved in the transaction will participate in the approval or ratification process only to provide additional information as requested for the review. Once initially approved or ratified, all transactions with related persons will be reviewed at least annually.

The policy does not require review or approval of the following transactions: (i) employment by the Company of an executive officer unless he or she is an immediate family member of another related person; (ii) any compensation paid by the Company to a director; and (iii) transaction in which a related person s interest arises solely from the ownership of equity securities and all holders of the securities receive the same benefit on a pro rata basis.

### Certain Transactions with Related Persons

The Company and its subsidiaries have transactions in the ordinary course of business with other corporations of which the Company s executive officers or directors or members of their immediate families are directors, executive officers, or stockholders. The amounts involved are below disclosure thresholds set by the SEC, or the executive officer or director or his or her family member does not have a direct or indirect material interest, as that term is used in SEC rules, in the transaction.

## SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company s directors and certain of its officers to send reports of their ownership of Company common stock and changes in such ownership to the SEC and the NYSE. The Company assists its directors and officers by preparing forms for filing. SEC regulations also require the Company to identify in this proxy statement any person subject to this requirement who failed to file a report on a timely basis. A Form 4 due June 14, 2008, for Mr. John F. Schaefer, Jr., relating to a stock option grant, was instead filed on June 25, 2008. Except for this report on Form 4, based on a review of copies of reports furnished to the Company and written representations that no other reports were required, the Company believes that everyone subject to Section 16(a) filed the required reports on a timely basis during 2008.

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## INDEPENDENT AUDITORS

### Selection of Independent Auditors for the Current Fiscal Year

The Audit Committee of the Board of Directors has selected KPMG LLP ( KPMG ) as the Company s independent auditors for the current fiscal year. Representatives of KPMG are expected to attend the meeting to respond to questions from stockholders and will have the opportunity to make a statement, if they wish to do so.

### Fees Paid to Independent Auditors

During fiscal years 2008, 2007 and 2006, the Company retained KPMG as its principal auditors. The independent auditors provided services in the following categories and amounts:

| | | |
|---|---|---|
| **2008** | | **KPMG LLP** |
| Audit Fees for the Company s Annual Financial Statements and Quarterly Reviews(1) | $ | 1,127,591 |
| Audit-Related Fees(2) | | 166,224 |
| All Other Fees(4) | | 30,500 |
| Total Fees for 2008 | $ | 1,324,315 |
| **2007** | | **KPMG LLP** |
| Audit Fees for the Company s Annual Financial Statements and Quarterly Reviews(1) | $ | 1,212,523 |
| Audit-Related Fees(2) | | 155,000 |
| Tax Fees(3) | | 24,159 |
| All Other Fees(4) | | 33,000 |
| Total Fees for 2007 | $ | 1,424,682 |
| **2006** | | **KPMG LLP** |
| Audit Fees for the Company s Annual Financial Statements and Quarterly Reviews(1) | $ | 1,219,139 |
| Audit-Related Fees(2) | | 175,718 |
| Tax Fees(3) | | 25,446 |
| All Other Fees(4) | | 34,417 |
| Total Fees for 2006 | $ | 1,454,720 |

(1) Audit fees represent the arranged fees for the years presented, including the annual audit of internal controls as mandated under Sarbanes-Oxley Section 404, and out-of-pocket expenses reimbursed during 2008.

(2) Consists of fees paid in connection with the audit of Air Group s employee benefit plans in all years and, in 2008, fees incurred in connection with the Form S-8 Registration Statement filed on June 18, 2008.

(3) Consists of fees paid for professional services in connection with tax consulting related to specific aircraft leasing and acquisition matters. These services were pre-approved by the Audit Committee.

(4) Consists of fees paid for professional services in connection with (i) the audit of passenger facility charges and examination of related controls, (ii) the examination of agreed-upon procedures for the U.S. Citizenship and Immigration Services, and

(iii) agreed-upon procedures regarding Air Group s employee incentive pay plans.
The Audit Committee has considered whether the provision of the non-audit services referenced above is compatible with maintaining the independence of the Company s independent auditors, and has determined that it does not impact the independence of the auditors.

**Independent Auditor Engagement Policy**

The Audit Committee has established an Independent Auditor Engagement Policy that is designed to ensure that the Company s auditor performs its services independently and with the highest integrity and professionalism. The Audit Committee reviews the policy annually.

The policy provides that any engagement of the Company s outside auditor must be consistent with principles determined by the SEC, namely, whether the independent auditor is capable of exercising impartial judgment on all issues encompassed within the auditor s engagement.

Permitted services under the policy include audit services, audit-related services, certain tax services and certain other services not

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prohibited by SEC rules or other federal regulations. Before retaining its independent auditor for non-audit services, the Audit Committee will consider factors such as whether the services might compromise the auditor s independence, whether the auditor is the best provider for the services, and the appropriate proportion of audit to non-audit services.

All services must be pre-approved by the Audit Committee except for certain services other than audit, review or attest services that meet the de minimis exception under 17 CFR Section 210.2-01, namely:

- the aggregate amount of fees paid for all such services is not more than five percent (5%) of the total fees paid by the Company to its auditor during the fiscal year in which the services are provided;
- such services were not recognized by the Company at the time of the engagement to be non-audit services; and
- such services are promptly brought to the attention of the Audit Committee and approved prior to the completion of the audit.

During fiscal years 2008, 2007 and 2006, there were no such services that were performed pursuant to the de minimis exception.

## AUDIT COMMITTEE REPORT

The following report of the Audit Committee shall not be deemed to be soliciting material or to be filed with the SEC under the Exchange Act, as amended, or incorporated by reference in any document so filed.

### Review of Our Company s Audited Financial Statements

The Audit Committee has reviewed and discussed with management and KPMG, the Company s independent auditors, the Company s audited financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008. We believe that management maintains an effective system of internal controls that results in fairly presented financial statements.

The discussions with KPMG also included the material and judgmental matters required by Statement on Auditing Standards No. 114, *The Auditor s Communication with Those Charged with Governance*, as amended, by the Auditing Standards Board of the American Institute of Certified Public Accountants.

We have also received and reviewed the written disclosures and the KPMG letter required by PCAOB Rule 3526, *Communicating with Audit Committees Concerning Independence*, and we have discussed with KPMG their independence.

Based on the review and discussions described above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in Alaska Air Group s Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

### Audit Committee Charter

The Audit Committee Charter is attached to this Proxy Statement as Exhibit A.

### Audit Committee of the Board of Directors

Patricia M. Bedient, Chairperson

Mark R. Hamilton, Member

Dennis F. Madsen, Member

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## SECURITY OWNERSHIP OF CERTAIN

## BENEFICIAL OWNERS AND MANAGEMENT

This table shows how much Company common stock is owned as of March 20, 2009, by (a) each director and nominee, (b) each of the Company s executive officers named in the Summary Compensation Table, and (c) all executive officers as a group. Except as otherwise indicated and subject to applicable community property laws, the persons named in the table below have sole voting and investment power with respect to all shares of common stock beneficially owned.

| Name | Number of Shares of Common Stock Owned(1) | Options Exercisable within 60 Days | Total Shares Beneficially Owned(2) | Percent of Outstanding Shares(3) |
|---|---|---|---|---|
| Patricia M. Bedient | 3,082 | 0 | 3,082 | |
| Phyllis J. Campbell | 3,224 | 0 | 3,224 | |
| Mark R. Hamilton | 2,345 | 0 | 2,345 | |
| Jessie J. Knight, Jr. | 4,252 | 0 | 4,252 | |
| R. Marc Langland | 5,848 | 0 | 5,848 | |
| Dennis F. Madsen | 3,938 | 0 | 3,938 | |
| Byron I. Mallott | 3,957 | 0 | 3,957 | |
| J. Kenneth Thompson | 8,082 | 0 | 8,082 | |
| William S. Ayer | 39,842 | 488,125 | 527,967 | |
| Bradley D. Tilden | 10,859 | 136,875 | 147,734 | |
| Glenn S. Johnson | 8,350 | 74,867 | 83,217 | |
| Gregg A. Saretsky | 5,136 | 97,640 | 102,776 | |
| Jeffrey D. Pinneo | 6,748 | 92,915 | 99,663 | |
| All directors and all executive officers as a group (18 persons) | 107,554 | 1,005,954 | 1,113,498 | % |

* Less than 1%

(1) Consists of the aggregate total of shares of common stock held by the reporting person either directly or indirectly, including 401(k) plan holdings.

(2) Total beneficial ownership is determined in accordance with the rules of the SEC and represents the sum of the columns Number of Shares of Common Stock Owned and Options Exercisable with 60 Days. Beneficial ownership does not include shares of common stock payable upon the vesting of restricted stock units, none of which will vest within 60 days, as follows: Mr. Ayer, 73,058; Mr. Tilden, 34,544; Mr. Johnson, 22,902; and Mr. Pinneo, 19,690.

(3) We determine applicable percentage ownership based on [ ] shares of our common stock outstanding as of March 20, 2009.

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The table below identifies those persons known by us to have beneficial ownership of more than 5% of the Company s outstanding common stock, as of March 20, 2009.

| Name and Address of Beneficial Owner | Number of Shares Owned | Percent of Outstanding Shares(1) |
|---|---|---|
| Dimensional Fund Advisors LP.( )<br>Palisades West, Building One<br>6300 Bee Cave Road<br>Austin, TX 78746 | 2,446,020 | 6.76 |
| PRIMECAP Management Company()<br>225 South Lake Avenue, #400<br>Pasadena, CA 91101 | 2,578,850 | 7.12 |
| Vanguard Chester Funds Vanguard PRIMECAP Fund ( )<br>100 Vanguard Boulevard<br>Malvern, PA 19355 | 2,400,000 | 6.63 |
| FMR LLC()<br>82 Devonshire Street<br>Boston, MA 02109 | 2,163,600 | 5.98 |

(1) We determine applicable percentage ownership based on [ ] shares of our common stock outstanding as of March 20, 2009.

( ) Beneficial ownership information is based on a Schedule 13G filed by FMR LLP on February 17, 2009. FMR reported that its subsidiary, Fidelity Management & Research Company ( Fidelity ) had sole voting power over all 2,163,600 shares.

( ) Beneficial ownership information is based on a Schedule 13G/A filed by Dimensional Fund Advisors LP. ( Dimensional ) on February 9, 2009. Dimensional reported in the Schedule 13G that, as an investment advisor registered under Section 203 of the Investment Advisors Act of 1940, it furnishes investment advice to four investment companies and serves as investment manager to other accounts (collectively, the Funds ), which hold the shares shown in the table above. To Dimensional s knowledge, the interest of any one Fund does not exceed 5% of the class of securities. Dimensional further reported that while it possesses voting and investment power over 2,395,517 shares and sole dispositive power over 2,446,020 shares, such shares are owned by the Funds, and Dimensional disclaims beneficial ownership of such shares.

( ) Beneficial ownership information is based on a Schedule 13G/A filed by PRIMECAP Management Company ( PRIMECAP ) on February 12, 2009. PRIMECAP reported in the Schedule 13G/A that it had sole voting power over 139,400 shares and sole dispositive power over all 2,578,850 shares.

( )

Beneficial ownership information is based on a Schedule 13G/A filed by Vanguard Chester Funds-Vanguard Primecap Fund ( Vanguard ) on February 13, 2009. Vanguard reported in the Schedule 13G/A that it had sole voting power over all 2,400,00 shares.

## COMPENSATION DISCUSSION AND ANALYSIS

### Executive Summary

This section contains a discussion of the material elements of compensation earned during 2008 by our Named Executive Officers listed in the Summary Compensation Table below: CEO of Alaska Air Group, Inc. Bill Ayer; President of Alaska Airlines, Inc. Brad Tilden; CFO of Alaska Air Group, Inc. Glenn Johnson; Jeff Pinneo, CEO of operating subsidiary Horizon Air Industries, Inc.; and Gregg Saretsky, an elected officer of subsidiary Alaska Airlines who had a policy-making role at the Alaska Air Group level. Mr. Saretsky resigned effective December 31, 2008.

The structure of our executive compensation program is designed to compensate executives appropriately and competitively and to drive superior performance. For our Named Executive Officers, a high percentage of total direct compensation is variable and tied to the success of the Company because they are the leaders primarily responsible for the overall execution of the Company s strategy. Our strategic goals are reflected in our incentive-based executive

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compensation programs so that executives interests are aligned with stockholder interests. Executive compensation is designed to be internally equitable, reflective of the business challenges facing the Company, and scaled to the industry.

## Objectives of our Executive Compensation Program

The objectives of our executive compensation programs, as determined by the Alaska Air Group Board Compensation Committee, are as follows:

- to attract and retain highly qualified executives who share our Company values and commitment to the Company s strategic plan by designing the total compensation package to be competitive with appropriate reference points as described below;

- to motivate executives to provide excellent leadership and achieve Company goals by linking short-term and long-term incentives to the achievement of specific goals as reflected in executives individual commitment plans, the Performance-Based Pay plan, and the Company s strategic plan;

- to align the interests of executives, employees, and stockholders by tying a large portion of our executives total direct compensation (base salary, short-term incentive pay, and equity awards) to the achievement of objective goals related to the Company s safety record, cost structure, employee engagement and profitability; and

- to provide executives with reasonable security, through a combination of performance-based incentives, retirement plans and change in control agreements that motivate them to continue employment with the Company and achieve goals that will help the Company remain competitive and thrive in the long term.

## How Executive Compensation is Determined

### *The Role of the Compensation Committee and Consultants*

The Compensation Committee determines and approves the Named Executive Officers compensation. The Committee has retained Grant Thornton LLP to provide advice with respect to trends in executive compensation, determination of pay programs, assessment of competitive pay levels and mix (e.g., proportion of fixed pay to variable pay, proportion of annual cash pay to long-term incentive pay), and setting compensation levels. When determining executive compensation, the Committee considers input from consultants in addition to several other factors described below.

### *How the Elements of our Executive Compensation Program were Selected*

The Compensation Committee conducts an annual review of the Company s executive compensation to ensure that it is structured to satisfy the Committee s objectives. The Committee considers how each component of compensation motivates executives to help the Company achieve its performance goals and how it promotes retention of executives who share the Company s values. Our compensation structure is designed to promote initiative, resourcefulness and teamwork by key employees whose performance and responsibilities directly affect our results of operations.

The Committee uses both fixed compensation and variable performance-based compensation to achieve a balanced program that is competitive and provides appropriate incentives. Base salaries, benefits, perquisites, retirement benefits, and change in control benefits are intended to attract and retain highly qualified executives and are paid out on a short-term or current basis. Annual incentives and long-term equity-based incentives are intended to motivate executives to achieve specific performance objectives.

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The Committee believes that this mix of short-term and longer-term compensation allows it to achieve dual goals of attracting and retaining highly qualified executives and providing meaningful performance incentives for those executives.

### *Executive Pay Mix and the Emphasis on Variable Pay*

The Compensation Committee believes that emphasis on variable compensation at the senior executive levels of the Company is a key element in achieving a pay-for-performance culture, aligning management s interests with those of the Company s stockholders. At the same time, the Committee does not believe that executive pay should motivate our executives to take unnecessary risks that could lead to misappropriation of stockholder resources or that would materially harm the Company s financial performance. The Committee, when determining executive pay, ensures that compensation is closely aligned with the overall strategy of the Company, with superior performance and stockholder return as the ultimate motivation.

Total direct compensation for a Named Executive Officer is tailored to place a substantial emphasis on pay that is tied to performance objectives. For 2008, the Committee approved target-level compensation for Mr. Ayer that is 80% variable and tied to stockholder value creation. With respect to the other Named Executive Officers, the Committee approved target compensation that is on average 67% variable.

In June 2008, the Committee offered equity grants to our Named Executive Officers designed to serve as long-term retention awards during a period where fuel prices were at record high prices and the Company s stock value had declined significantly. All of our Named Executive Officers elected to forgo these awards. The Committee appreciates the level of commitment and leadership shown by the executive team by this action.

### *The Use of Benchmarking*

Periodically, the Committee reviews and analyzes total direct compensation at the executive level. When data was last reviewed, the analysis included the use of benchmarking to provide a review of total direct compensation as compared to market data. For this purpose, the Committee considered air carrier peer group data as well as general industry data. The data was weighted two-thirds airline and one-third general industry to identify a market consensus compensation level for each executive position. For the analysis of market consensus, the Committee applied a greater focus on peer group air carriers because these are the primary companies that compete with the Company for key talent, customers, and stockholder investment. Peer group air carrier companies also receive greater emphasis because in our industry the vast majority of our employees are unionized and have pay that is often compared to their industry peers. At last

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review, the peer group consisted of Air Tran Holdings, AMR Corporation, Continental Airlines Inc., Delta Air Lines Inc., Frontier Airline Holdings, JetBlue Airways Corporation, Southwest Airlines Corporation, UAL Corporation and US Airways Group Inc. The Committee also considers general industry data of companies with similar revenues because it recognizes that our executives have opportunities outside the industry.

***The Application of Internal Equity Considerations***

The Committee believes that the appropriate way to compensate executive officers is to consider many principles of compensation, including internal equity. The Committee recognizes that CEO compensation at many publicly traded companies in the United States has dramatically increased over a short period of time and has received heightened scrutiny recently with current economic issues. The Committee recognizes that compensation data is susceptible to ratcheting. This leads the Committee, with the CEO s full support, to not blindly accept benchmarking data to set compensation levels. Thus, while the Committee has considered peer group data as described above, it has also applied other compensation principles such as internal equity when determining CEO compensation. As a result, the Committee s determination of total direct compensation for the CEO position reflects a substantial discount from market consensus. At current levels, the CEO s total direct compensation represents approximately two times that of the Executive Vice President level, and approximately four times that of the Vice President level. By considering internal equity, the Committee believes that the resulting data points are more reliable and more insulated from external ratcheting effects.

***The Use of Tally Sheets and Wealth Accumulation Analysis***

Annually, the Committee reviews tally sheets that show each element of compensation for Named Executive Officers. Base salaries, benefit values, incentive plan payments, equity awards, equity exercises, perquisites, and retirement benefits are included on tally sheets. The Company s corporate affairs and human resources departments prepare the tally sheets. To date, the Committee s use of tally sheets has provided verification that executive compensation is internally equitable and proportioned according to the Committee s expectations with regard to executive compensation.

***The Use of Performance Measures***

The Committee uses objective performance goals in the Performance-Based Pay annual incentive plan. The Committee also uses performance measures in long-term equity awards by utilizing restricted stock unit, stock option, and performance stock unit awards. Annual incentives and long-term incentives are intended to motivate executives to achieve superior performance levels by setting goals that are tied to the Company s strategic plan and by linking executives compensation to long-term stockholder gain. All non-union employees and certain union groups at our Company participate in the Performance-Based Pay plan. We believe this motivates all employees to achieve the same goals and ensures that the targets are the focus of all employees across the Company.

**Current Executive Pay Elements**

***Base Pay***

In general, for Named Executive Officers, the Committee targets base salary levels in the 25$^{th}$ percentile based on market consensus data identified in the review described above. The Committee assesses each executive s duties and scope of responsibilities, past performance and expected future contributions to the Company, the market demand for the individual s skills, the individual s influence on long-term Company strategies and success, the individual s leadership performance, and internal equity.

At the initiation of Mr. Ayer, the Committee accepted that his base salary for 2008 remain at the same level it had for the past three years, and lower than it had been in the three years prior to that. The Committee believes that Mr. Ayer s leadership in this matter has been

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invaluable in defining and re-affirming the Company s core values and employee commitment to the strategic plan. In 2008, Mr. Ayer s base salary was in the bottom quartile compared to the most recent information reviewed from our peer group. The chart below depicts CEO base salaries at airline peer group companies.

**CEO Base Pay Comparisons (Airlines)**

| | | |
|---|---|---|
| **2006, 2007 and 2008 Base Salary** | | |
| Alaska Air Group, Inc. | $ | 360,000 |
| **Base Salary (Air Group peers)*** | | |
| Air Tran Holdings | $ | 444,039 |
| AMR Corporation | $ | 656,500 |
| Continental Airlines, Inc. | $ | 712,500 |
| Delta Air Lines, Inc.** | $ | 600,000 |
| Frontier Airline Holdings*** | $ | 345,165 |
| JetBlue Airways Corporation* | $ | 375,000 |
| Southwest Airlines Corporation | $ | 429,167 |
| UAL Corporation | $ | 850,000 |
| US Airways Group, Inc. | $ | 550,000 |
| **Average Base Salary (Air Group peers)** | **$** | **551,375** |

* Amounts are derived from most recent compensation data available as of the date of this proxy statement. In most cases, this is the 2007 base salary as reported in the respective company s proxy statement. JetBlue compensation data represents 2008 base salary as reported in a July 28, 2008 Form 8-K.

** Per Delta Air Line, Inc. s 2008 proxy, only one-third of the 2007 salary for the CEO was paid and was listed as $200,000.

*** Includes the combination of the salary of the former CEO and the current CEO for Frontier s 2007 2008 fiscal year.

The Committee believes that 25th percentile base salary levels for the other Named Executive Officers, with the opportunity to earn market-level compensation through short- and long-term incentive plans that pay when performance objectives are met, are appropriate. The base salary levels of the other Named Executive Officers averaged in the 25th percentile when last reviewed.

***Performance-Based Annual Pay***

Our Named Executive Officers are eligible to earn annual incentive pay under our Performance-Based Pay plan, which is intended to motivate the executives to achieve specific Company goals. The Committee aligns executive compensation with the Company s strategic plan by choosing a target level performance for the Performance-Based Pay plan that is consistent with the Company s strategic plan goals.

Each participant in the Performance-Based Pay plan is assigned a target participation level, expressed as a percentage of the participant s base salary. For the Named Executive Officers, the 2008 target participation levels are as follows:

**Performance-Based Pay Plan Participation**

| Name | Target Participation as % of Base Salary |
|---|---|

| | |
|---|---|
| William S. Ayer | 100% |
| Bradley D. Tilden | 75% |
| Glenn S. Johnson | 75% |
| Gregg A. Saretsky | 75% |
| Jeffrey D. Pinneo | 75% |

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Incentive award payments may range from zero to 200% of the Named Executive Officers target based on the achievement of the objective performance standards set by the Compensation Committee at the beginning of each year. For 2008, the Performance-Based Pay Plan metrics were set as follows:

### Performance-Based Pay Metrics

| | | Threshold | | Target | | Maximum | |
|---|---|---|---|---|---|---|---|
| **Goal** | **Weight** | **Alaska** | **Horizon** | **Alaska** | **Horizon** | **Alaska** | **Horizon** |
| Operational Performance | | | | | | | |
| Safety lost-time injuries per 100 full-time employees | 10% | 4.88 or fewer | 3.9 or fewer | 4.64 or fewer | 3.71 or fewer | 4.39 or fewer | 3.51 or fewer |
| Employee Engagement (as measured by the number of months we exceed our monthly customer satisfaction goal) | 10% | 3 months | | 5 months | | 9 months | |
| CASM ex fuel (cost per available seat mile) | 10% | 7.60¢ | 14.57¢ | 7.50¢ | 14.35¢ | 7.25¢ | 14.76¢ |
| AAG Profitability | | | | | | | |
| Adjusted Pre-tax Profit | **70%** | **$100 million** | | **$190 million** | | **$300 million** | |

Target performance is set according to measures that will keep the Company on course for achieving goals consistent with the strategic plan. Maximum targets are approximately one and one-half times target, and intended to set goals for superior performance. Threshold goals are set to improve year-over-year performance. The 2008 Alaska Air Group profitability target was established by identifying the level of profitability achieved with a 6% adjusted pre-tax profit margin. The Safety and Employee Engagement metrics were set to drive continuous improvement on those measures. The Cost per Available Seat Mile metric was similarly chosen to promote the Company s progress on its strategic plan. The modifiers were selected to align with each subsidiary s key initiative for 2008.

For 2008, a modifier was added to the Performance-Based Pay plan that results in plus or minus ten percentage points based on the performance of key metrics as detailed below:

| **Modifier** | **-10 pts** | **-8 pts** | **-6 pts** | **-4 pts** | **-2 pts** | **No Adj** | **+2 pts** | **+3 pts** | **+4 pts** | **+5 pts** | **+6 pts** | **+8 pts** | **+10 pts** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Alaska** | | | | | | | | | | | | | |
| Number of months Alaska achieves on-time performance goal | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |

| **Modifier** | **-10 pts** | **-8 pts** | **-6 pts** | **-4 pts** | **-2 pts** | **No Adj** | **No Adj** | **+2 pts** | **+4 pts** | **+6 pts** | **+8 pts** | **+10 pts** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Horizon** | | | | | | | | | | | | |
| Horizon s pre-tax profit margin | -5% | -4% | -3% | -2% | -1% | 0 | 1% | 2% | 3% | 4% | 5% | 6% |

Historically, the Performance-Based Pay plan has paid out as follows:

In addition, all of our employees, including our executive officers, participate in a separate incentive plan called Operational Performance Rewards, which pays a monthly incentive payment of an equal amount to all employees when particular operational performance targets are met. Awards are based on operational performance and customer satisfaction, and the maximum annual payout for each employee is $1,200.

### *Long-Term Equity-Based Pay*

An important element of our executive compensation program is our long-term equity-based incentive awards, which link executive pay to stockholder value. Our long-term equity incentives are awarded annually and are primarily intended to align Named Executive Officers long-term interests with stockholders long-term interests, although we believe that by promoting stock ownership by our executives, they also play a role in helping us to attract and retain top-performing executives who fit a team-oriented and performance-driven culture.

### *Stock Options*

The Company makes a portion of its long-term incentive grants to Named Executive Officers in the form of stock options with an exercise price that is equal to the fair market value of our common stock on the grant date. Thus, the Named Executive Officers will only realize value on their stock options if our stockholders realize value on their shares. The stock options also function as a retention incentive for our executives as they vest ratably over the four-year period after the date of grant.

### *Restricted Stock Units*

The Company also grants long-term incentive awards to Named Executive Officers in the form of restricted stock units. Subject to the executive s continued employment with the Company, the restricted stock units vest only on the third anniversary of the date they are granted and, upon vesting, are paid in shares of our common stock. Thus, the units are designed to link executives interests with those of our stockholders (as the units value is based on the value of our common stock) and to provide a long-term retention incentive through the vesting period.

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### *Performance Stock Units*

For 2008, the Company granted the Named Executive Officers performance stock units as part of our long-term equity-based incentive program. The stock units will vest only if the Company achieves a pre-determined average pre-tax profit margin over the course of three years. For 2008, the Compensation Committee set target performance at 6% adjusted pre-tax profit margin (referred to as APM in the table below), which was consistent with the goal of the Company and to the target set for the Performance-Based Pay plan.

The Committee reviews equity grant guidelines that are modeled according to the total direct compensation levels and pay mix described above. Target equity grants, when combined with all other compensation elements, are designed to achieve total direct compensation at the 50th percentile of market consensus for Named Executive Officers. Named Executive Officers equity grants may be adjusted above or below target based on:

- the individual s contribution to the success of the Company s financial performance;
- internal equity;
- the individual s performance of his job responsibilities; and
- the accounting impact to the Company and potential dilution effects of the grant.

For our Named Executive Officers, equity incentive awards are proportioned according to a formula that considers the risk inherent in the various equity vehicles. For 2008, the guidelines applied to the Named Executive Officers are noted in the table below:

| Name | Equity Target as % of Base Pay | Equity Mix: Stock Options | Equity Mix: Restricted Stock Units | Equity Mix: Performance Stock Units |
|---|---|---|---|---|
| William S. Ayer | 300% | 40% | 20% | 40% |
| Bradley D. Tilden | 200% | 40% | 20% | 40% |
| Glenn S. Johnson | 200% | 40% | 20% | 40% |
| Gregg A. Saretsky | 200% | 40% | 20% | 40% |
| Jeffrey D. Pinneo | 200% | 40% | 20% | 40% |

In 2007 and 2008, by designating a proportion of an executive s compensation in performance stock units, the Compensation Committee aimed to further align total direct compensation for executives with the Company s strategic plan goals. Based on actual performance in the past two years, we do not currently expect to meet the threshold APM, resulting in a zero vesting percentage. Current economic trends and volatility in the marketplace have led the Compensation Committee to consider the optimal equity mix for incentivizing performance. While the Committee considers this, they have determined not to grant performance stock units in 2009. In 2009, the equity mix will be 50% stock options and 50% restricted stock units.

The 2008 grant of performance stock units was set according to the following metrics:

| Performance Share Metrics | |
|---|---|
| APM (three-year | Percentage of Stock |

| average) | Units that Vest |
|---|---|
| Less than 3% | 0% |
| 3% | 25% |
| 4% | 50% |
| 5% | 75% |
| 6% | 100% |
| 7% | 125% |
| 8% | 150% |
| 9% | 175% |
| 10% and above | 200% |

### Stock Ownership Guidelines

In 2009, the Company adopted stock ownership guidelines for elected officers. Under the guidelines, elected officers are strongly encouraged to hold Company stock having a value of one year s base salary.

### Perquisites and Personal Benefits

In 2008, the Committee determined that an annual amount of 12% of base salary would be paid to each Named Executive Officer in lieu of all perquisites except for travel, life insurance, health exams, AD&D insurance, and Alaska Airlines Boardroom membership.

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### Retirement Benefits/Deferred Compensation

The Company provides retirement benefits to the Named Executive Officers under the terms of qualified and non-qualified defined-benefit retirement plans. The Retirement Plan for Salaried Employees (the Salaried Retirement Plan ) and the Company s 401(k) plans are tax-qualified retirement plans that the Named Executive Officers participate in on substantially the same terms as other participating employees. Due to maximum limitations imposed by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code on the annual amount of a pension which may be paid under a qualified defined benefit plan, the benefits that would otherwise be payable to the Named Executive Officers under the Salaried Retirement Plan are required to be limited. An unfunded defined benefit plan, the 1995 Elected Officers Supplementary Retirement Plan (the Supplementary Retirement Plan ), provides supplemental retirement benefits.

The Named Executive Officers are also permitted to elect to defer up to 100% of their annual Performance-Based Pay payments under the Company s Nonqualified Deferred Compensation Plan. The Company believes that providing the Named Executive Officers with deferred compensation opportunities is a cost-effective way to permit executives to receive the tax benefits associated with delaying the income tax event on the compensation deferred.

Please see the 2008 Pension Benefits and 2008 Nonqualified Deferred Compensation tables and information following them for a description of these plans.

In 2008, the Company amended certain benefit plans and other deferred compensation arrangements (including equity award agreements) to comply with the IRS s deferred compensation rules under Section 409A of the Internal Revenue Code. The amendments did not increase the intended benefits to participants under these plans.

### Agreements Regarding Change in Control and Termination

Upon a leadership restructuring in December 2008, we entered into a separation agreement with Mr. Saretsky, who served as Alaska Airlines, Inc. s Executive Vice President/Flight and Marketing until December 10, 2008. Under the terms of the agreement, Mr. Saretsky served through December 31, 2008 as Executive Vice President/Strategic Projects and resigned effective December 31, 2008. The full description of Mr. Saretsky s termination arrangements are set forth in footnote 5 to the 2008 Summary Compensation Table on page [ ]. We do not have employment agreements in place with our other Named Executive Officers, although we do have change in control agreements with them.

In recognition that the occurrence, or potential occurrence, of a change in control transaction will create uncertainty and disruption during a critical transaction time for the Company, we have entered into change in control agreements with our Named Executive Officers. The agreements are intended to balance the interests of stockholders and executives in the event of a change in control of the Company. The payment of cash severance benefits is only triggered by an actual or constructive termination of employment following a change in control transaction because we believe that Named Executive Officers should be entitled to receive cash severance benefits only if both conditions are met. Once the change in control event commences, the Named Executive Officer s severance and benefits payable under the contract begins to diminish with time, until ultimate expiration of the agreement 36 months later.

The Company s equity award agreements state that equity will vest on an accelerated basis in the event of a change in control plus actual or constructive discharge of the executive.

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### Policy with Respect to Section 162(m)

Section 162(m) of the Internal Revenue Code generally prohibits the Company from deducting certain compensation over $1 million paid to its chief executive officer and certain other executive officers unless such compensation is based on performance objectives meeting certain criteria or is otherwise excluded from the limitation. The Company strives whenever possible to structure its compensation plans such that they are tax deductible and believes that a substantial portion of compensation paid under its current program (including the annual incentives and stock option grants described above) satisfies the requirements under Section 162(m). However, the Company reserves the right to design programs that recognize a full range of performance criteria important to its success, even where the compensation paid under such programs may not be deductible. For 2008, the Company believes that no portion of its tax deduction for compensation paid to its Named Executive Officers will be disallowed under Section 162(m).

## COMPENSATION COMMITTEE REPORT(1)

The Compensation Committee has certain duties and powers as described in its charter. The Compensation Committee is currently composed of the three non-employee directors named at the end of this report, each of whom is independent as defined by the NYSE listing standards.

The Compensation Committee has reviewed and discussed with management the disclosures contained in the Compensation Discussion and Analysis section of this proxy statement. Based upon this review and discussion, the Compensation Committee recommended to our Board of Directors that the Compensation Discussion and Analysis section be included in the Company s 2008 Annual Report on Form 10-K on file with the SEC.

### Compensation Committee of the Board of Directors

Phyllis J. Campbell, Chairperson

Jessie J. Knight, Jr., member

Dennis F. Madsen, member

## COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee members whose names appear on the Compensation Committee Report above were committee members during all of 2008. No member of the Compensation Committee during 2008 is or has been a former or current executive officer or employee of the Company or has had any relationships requiring disclosure by the Company under the SEC s rules requiring disclosure of certain relationships and related-party transactions. None of the Company s executive officers served as a director or a member of a compensation committee (or other committee serving an equivalent function) of any other entity, the executive officers of which served as a director or member of the Compensation Committee during the fiscal year ended December 31, 2008.

(1) SEC filings sometimes incorporate information by reference. This means the Company is referring you to information that has previously been filed with the SEC and that this information should be considered as part of the filing you are reading. Unless the Company specifically states otherwise, this report shall not be deemed to be incorporated by reference and shall not constitute soliciting material or otherwise be considered filed under the Securities Act or the Exchange Act.

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## 2008 SUMMARY COMPENSATION TABLE

The following table presents information regarding compensation of our CEO, our CFO and our three other most highly compensated executive officers for services rendered during 2008. These individuals are referred to as Named Executive Officers in this Proxy Statement.

| Name and Principal Position (a) | Year (b) | Salary ($) (c) | Bonus ($) (d) | Stock Awards ($)(1) (e) | Option Awards ($)(1) (f) | Non-Equity Incentive Plan Compensation ($)(2) (g) | Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(3) (h) | All Other Compensation ($)(4) (i) | Total ($) (j) |
|---|---|---|---|---|---|---|---|---|---|
| William S. Ayer Chairman, President and CEO | 2008 | 360,000 | 0 | 328,046 | 885,150 | 186,840 | 194,473 | 68,155 | 2,022,664 |
| | 2007 | 360,000 | 0 | 598,176 | 834,088 | 76,320 | 29,644 | 47,508 | 1,945,736 |
| | 2006 | 360,000 | 0 | 302,484 | 1,268,286 | 538,965 | 57,541 | 55,402 | 2,582,678 |
| Bradley D. Tilden(5) President (Alaska Airlines) | 2008 | 278,538 | 0 | 155,493 | 269,181 | 108,421 | 57,324 | 55,181 | 924,138 |
| | 2007 | 260,000 | 0 | 260,216 | 191,790 | 41,340 | 171,291 | 43,754 | 968,391 |
| | 2006 | 260,000 | 0 | 130,554 | 165,957 | 233,531 | 49,450 | 69,389 | 908,881 |
| Glenn S. Johnson(5) Executive Vice President/Finance and CFO | 2008 | 277,462 | 0 | 139,923 | 201,018 | 108,002 | 637,129 | 49,556 | 1,413,090 |
| | 2007 | 251,135 | 0 | 162,825 | 126,514 | 35,471 | 94,893 | 45,599 | 716,437 |
| | 2006 | 219,115 | 0 | 119,917 | 118,341 | 114,805 | 76,946 | 43,382 | 692,506 |
| Gregg A. Saretsky(6) Former Executive Vice President/ Marketing and Flight | 2008 | 294,000 | 0 | 327,080 | 788,418 | 114,440 | 80,627 | 96,508 | 1,701,073 |
| | 2007 | 280,000 | 0 | 257,927 | 194,388 | 44,520 | 35,290 | 46,621 | 858,746 |
| | 2006 | 280,000 | 0 | 135,092 | 171,045 | 243,204 | 104,362 | 81,705 | 1,015,408 |
| Jeffrey D. Pinneo(7) President and CEO (Horizon Air Industries) | 2008 | 237,000 | 0 | 120,421 | 203,968 | 78,032 | 150,068 | 63,103 | 852,592 |
| | 2007 | 237,000 | 0 | 221,759 | 149,749 | 35,550 | 803,632 | 52,094 | 1,499,784 |
| | 2006 | 237,000 | 0 | 117,593 | 148,232 | 209,995 | 30,202 | 60,917 | 803,939 |

(1) The amounts reported in Columns (e) and (f) of the Summary Compensation Table above reflect the aggregate dollar amounts recognized for stock awards and option awards, respectively, for financial statement reporting purposes in each of the years presented (disregarding any estimate of forfeitures related to service-based vesting conditions). 2006 and 2007 have been restated to reflect the revised financial statement impact of equity awards in each of those years. No stock awards or option awards granted to Named Executive Officers were forfeited in any of the three years presented. For a discussion of the assumptions and methodologies used to value the awards reported in Column (e) and Column (f) and for a description of the restatement of prior period equity-based compensation expense, please see the discussion of stock awards and option awards

contained in Note 12 (Stock-Based Compensation Plans) to the Company s Consolidated Financial Statements, included as part of the Company s 2008 Annual Report filed on Form 10-K with the SEC and incorporated herein by reference. For information about the stock awards and option awards granted to our Named Executive Officers for 2008, please see the discussion under Grants of Plan-Based Awards below.

(2) Non-Equity Incentive Plan Compensation is Performance-Based Pay Plan compensation, further described in the Compensation Discussion and Analysis section above.

(3) The amount reported in Column (h) of the Summary Compensation Table above reflects the year-over-year change in present value of accumulated benefits determined as of December 31 of each year for the Retirement Plan for Salaried Employees and the Officers Supplementary Retirement Plan as well as earnings on each Named Executive Officer s account under the Nonqualified Deferred Compensation Plan.

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(4) The following table presents detailed information on the types and amounts of compensation reported for the Named Executive Officers in Column (i) of the Summary Compensation Table. For Column (i), each perquisite and other personal benefit is included in the total and identified and, if it exceeds the greater of $25,000 or 10% of the total amount of perquisites and other benefits for that officer, is quantified in the table below. All reimbursements of taxes with respect to perquisites and other benefits are identified and quantified. Also included in the total for Column (i) are: the Company s incremental cost of providing flight benefits; Alaska Airlines Board Room membership; annual physical; accidental death and dismemberment insurance premiums; and gas allowance, hotel allowance, financial, tax and estate planning, or perquisite allowance in lieu of these items in 2008.

| Name | Company Contribution to 401(k) Account | Term Life Insurance Premiums (and Taxes Paid) | Medical Insurance Premiums (and Taxes Paid) | Perquisite Allowance | Travel Taxes Paid |
|---|---|---|---|---|---|
| William S. Ayer | $ 6,900 | $1,164 ($668) | $10,469 ($0) | $ 43,200 | $ 4,893 |
| Bradley D. Tilden | $ 6,900 | $650 ($373) | $10,469 ($0) | $ 33,877 | $ 19,085 |
| Glenn S. Johnson | $ 6,900 | $673 ($386) | $6,684 ($0) | $ 33,692 | $ 11,231 |
| Gregg A. Saretsky | $ 4,735 | $650 ($373) | $10,469 ($0) | $ 33,600 | $ 28,275 |
| Jeffrey D. Pinneo | $ 15,500 | $690 ($396) | $8,510 ($3,772) | $ 28,382 | $ 10,413 |

(5) Mr. Tilden was elected President of Alaska Airlines, Inc. in December 2008. His base salary is $340,000 effective December 4, 2008.

Mr. Johnson was elected Executive Vice President/Finance and CFO of Alaska Air Group, Inc. in December 2008. His base salary is $300,000 effective December 4, 2008. In 2008, Mr. Johnson became partially vested under the Supplementary Retirement Plan, and earned sufficient service under the Plan to accrue a benefit payable at his Normal Retirement Age. As a result of these changes, $574,992 is included in the Summary Compensation Table in Column (h) as the Change in Pension Value and is attributable to Mr. Johnson s vesting and service accruals under the Supplementary Retirement Plan during 2008.

(6) Mr. Saretsky resigned effective December 31, 2008. The amount reported in Column (i) for Mr. Saretsky also includes certain payments made pursuant to his Separation Agreement with the Company dated December 10, 2008. Mr. Saretsky received a $32,308 in payment of all accrued and unused vacation and a $12,000 payment in lieu of outplacement services pursuant to the agreement. Not included in the totals are separation payments of $23,350 per month for 17 months beginning January 2009, and a monthly consulting payment of $31,817 per month for 12 months beginning January 2009. In lieu of continuing health care benefits, Mr. Saretsky received a lump sum of $36,000 which represents the estimated aggregate cost of medical coverage for a period of two years following his separation from the Company. Additionally, all of his outstanding option awards and restricted stock units became vested on January 5, 2009. As such, all unamortized compensation expense as of December 31, 2008 was recorded in 2008 and is reflected in columns (e) and (f) appropriately.

(7) In 2007, Mr. Pinneo became partially vested under the Supplementary Retirement Plan, and earned sufficient service under the Plan to accrue a benefit payable at his Normal Retirement Age. As a result of these changes, $802,627 is included in the Summary Compensation Table in Column (h) as the Change in Pension Value and is attributable to Mr. Pinneo s vesting and service accruals under the Supplementary Retirement Plan during 2007. This accrual also includes Mr. Pinneo s nonqualified benefits described in the paragraph below. The Supplementary Retirement Plan and the nonqualified benefits are payable over the long-term after Mr. Pinneo retires from the Company.

When Mr. Pinneo was elected President and CEO of Horizon Air in 2002, he was 100% vested under the Salaried Retirement Plan on account of prior service at Alaska. At that time, Horizon Air, which does not have a plan similar to the Salaried Retirement Plan, agreed to supplement his benefits to ensure that his retirement benefit will be equivalent to what he would have received had he been participating in the Salaried Retirement Plan during his tenure as President and CEO of Horizon Air.

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## Other Information

The Company is required to include in its Summary Compensation Table the expense recorded for financial statement reporting purposes associated with stock and option awards. However, we believe a more accurate method of considering the value of these awards is to use the current intrinsic value for equity awards granted during the reported period. As such, the following table displays total compensation using this intrinsic value methodology for stock and option awards. This table is not part of the Summary Compensation Table.

**Total Compensation Using Intrinsic Value of Equity Awards Granted**

| Name | Year | Salary ($) | Intrinsic Value of Equity Awards Granted Using the March 12, 2009 Stock Price ($) | Non-Equity Incentive Plan Compensation ($) | Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) | All Other Compensation ($) | Total ($) |
|---|---|---|---|---|---|---|---|
| William S. Ayer | 2008 | 360,000 | 197,393 | 186,840 | 194,473 | 68,155 | 1,006,861 |
| | 2007 | 360,000 | 88,296 | 76,320 | 29,644 | 47,508 | 601,768 |
| | 2006 | 360,000 | 0 | 538,965 | 57,541 | 55,402 | 1,011,908 |
| Bradley D. Tilden | 2008 | 278,538 | 106,974 | 108,421 | 57,324 | 55,181 | 606,438 |
| | 2007 | 260,000 | 54,336 | 41,340 | 171,291 | 43,754 | 570,721 |
| | 2006 | 260,000 | 89,994 | 233,531 | 49,450 | 69,389 | 702,364 |
| Glenn S. Johnson | 2008 | 277,462 | 86,598 | 108,002 | 637,129 | 49,556 | 1,158,747 |
| | 2007 | 251,135 | 18,508 | 35,471 | 94,893 | 45,599 | 445,606 |
| | 2006 | 219,115 | 61,298 | 114,805 | 76,946 | 43,382 | 515,546 |
| Gregg A. Saretsky | 2008 | 294,000 | 86,598 | 114,440 | 80,627 | 96,508 | 672,173 |
| | 2007 | 280,000 | 45,846 | 44,520 | 35,290 | 46,621 | 452,277 |
| | 2006 | 280,000 | 89,994 | 243,204 | 104,362 | 81,705 | 799,265 |
| Jeffrey D. Pinneo | 2008 | 237,000 | 74,712 | 78,032 | 150,068 | 63,103 | 602,915 |
| | 2007 | 237,000 | 39,054 | 35,550 | 803,632 | 52,094 | 1,167,330 |
| | 2006 | 237,000 | 76,240 | 209,995 | 30,202 | 60,917 | 614,354 |

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## 2008 GRANTS OF PLAN-BASED AWARDS

The following table presents information regarding the incentive awards granted to the Named Executive Officers for 2008. Each of the equity-based awards reported in the table below was granted under our 2004 Plan.

| | | Estimated Possible Payouts Under Non-Equity Incentive Plan Awards | | | Estimated Future Payouts Under Equity Incentive Plan Awards(1) | | | All Other Stock Awards: Number of Shares of Stock or Units | All Other Option Awards: Number of Securities Underlying Options | Exercise or Base Price of Option Awards | Grant Date Fair Value of Stock and Option Awards |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Name | Grant Date(2) | Thres-hold ($) | Target ($) | Maximum ($) | Thres-hold (#) | Target (#) | Maximum (#) | (#) | (#) | ($/Sh) | ($)(3) |
| (a) | (b) | (c) | (d) | (e) | (f) | (g) | (h) | (i) | (j) | (k) | (l) |
| William S. Ayer | 2/8/08 | 0 | 0 | 0 | 5,525 | 22,100 | 44,200 | 11,625 | 52,800 | 27.49 | 966,012 |
| | N/A | 0 | 360,000 | 720,000 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bradley D. Tilden | 2/8/08 | 0 | 0 | 0 | 2,875 | 11,500 | 23,000 | 6,300 | 27,400 | 27.49 | 508,651 |
| | N/A | 0 | 208,903 | 417,807 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Glenn S. Johnson | 2/8/08 | 0 | 0 | 0 | 2,300 | 9,200 | 18,400 | 5,100 | 21,900 | 27.49 | 408,325 |
| | N/A | 0 | 208,097 | 416,193 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Gregg A. Saretsky | 2/8/08 | 0 | 0 | 0 | 767(4) | 3,067(4) | 6,133(4) | 5,100 | 21,900 | 27.49 | 408,325 |
| | N/A | 0 | 220,500 | 441,000 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Jeffrey D. Pinneo | 2/8/08 | 0 | 0 | 0 | 1,950 | 7,800 | 15,600 | 4,400 | 18,500 | 27.49 | 347,455 |
| | N/A | 0 | 177,750 | 355,500 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

(1) Threshold, target and maximum are based on 25%, 100% and 200% estimated future payouts of performance stock units in shares of common stock, respectively.

(2) Each of the Named Executive Officers was offered an equity award in June 2008. Each of them elected to forgo the grant.

(3) The amounts reported in Column (l) reflect the fair value of these awards on the grant date as determined under the principles used to calculate the value of equity awards for purposes of the Company s financial statements and may or may not be representative of the value eventually realized by the executive. For a discussion of the assumptions and methodologies used to value the awards reported in Column (l), please see the discussion of stock awards and option awards contained in Note 10 (Stock-Based Compensation Plans) to the Company s Consolidated Financial Statements, included as part of the Company s 2008 Annual Report filed on Form 10-K with the SEC and incorporated herein by reference.

(4) Under the terms of Mr. Saretsky s Separation Agreement and the terms of the Performance Stock Unit Award Agreement, performance stock units vest based on the duration of employment in the performance period. As such, Mr. Saretsky can only be eligible for one-third of the performance stock units granted in 2008.

### Description of Equity-Based Awards

Each of the equity-based awards reported in the Grants of Plan-Based Awards Table was granted under, and is subject to, the terms of the 2004 Plan, both of which are administered by the Compensation Committee. The Committee has authority to interpret the plan provisions and make all required determinations under the plans. This authority includes making required proportionate adjustments to outstanding awards upon the occurrence of certain corporate events such as reorganizations, mergers and stock splits, and making provisions to ensure that any tax withholding obligations incurred in respect of awards are satisfied. Unless otherwise provided by the Committee, awards granted under the plans are generally only transferable to a beneficiary of a Named Executive Officer upon his death.

### Options

Each option reported in Column (j) of the table above was granted with a per-share exercise price equal to the fair market value of a share of our common stock on the grant date. For these purposes, and in accordance with the terms of the 2004 Plan and our option grant practices, the fair market value is equal to the closing price of a share of our common stock on the applicable grant date in Column (k).

Each option granted to our Named Executive Officers in 2008 is subject to a four-year vesting

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schedule, with 25% of the options vesting on each of the first four anniversaries of the grant date. Once vested, each option will generally remain exercisable until its normal expiration date. Each of the options granted to our Named Executive Officers in 2008 has a term of ten years. If a Named Executive Officer s employment terminates for any reason other than due to his death, disability or retirement, the unvested portion of the options will immediately terminate. If the Named Executive Officer s employment is terminated as a result of the officer s death or disability, the options will immediately vest and become exercisable. If the Named Executive Officer s employment is terminated as a result of the officer s retirement, the options will continue to vest and become exercisable over the three-year period following the retirement date (subject to earlier termination at the end of the option s stated term). For these purposes, retirement generally means a termination of employment on or after attaining age 60, attaining age 55 with at least five years of service with the Company, or becoming entitled to commence benefits under a Company-sponsored defined benefit plan in which the officer participates (with at least 10 years service). Unless otherwise provided by the Board of Directors, if there is a change in control of the Company, the options will generally become fully vested and exercisable.

The options granted to Named Executive Officers during 2008 do not include any dividend rights.

### Restricted Stock Units

Column (i) of the table above reports awards of restricted stock units granted to our Named Executive Officers for 2008. Each restricted stock unit represents a contractual right upon vesting to receive one share of our common stock. Restricted stock units granted to our Named Executive Officers for 2008 will vest in one installment on the third anniversary of the grant date, provided that the officer continues to be employed with the Company through that date. However, the restricted stock units will become fully vested if the Named Executive Officer s employment terminates due to the officer s death or disability. If the Named Executive Officer s employment terminates due to the officer s retirement, the restricted stock units will continue to vest for the three-year period following the retirement date. (See the description of Options above for the definition of retirement. ) Unless otherwise provided by the Board of Directors, the restricted stock units will also generally become fully vested upon a change in control of the Company.

The restricted stock units granted to Named Executive Officers during 2008 do not include any dividend rights.

### Performance Stock Units

Column (g) of the table above reports awards of performance stock units granted to our Named Executive Officers for 2008. Columns (f) and (h) show threshold and maximum payout potential, respectively, for each award. Like restricted stock units, each performance stock unit represents a contractual right upon vesting to receive one share of our common stock. Performance stock units granted to our Named Executive Officers for 2008 will generally vest based on the Company s achievement of pre-established performance goals for the adjusted pre-tax profit margin over a three-year period as described in the Compensation Discussion and Analysis section above. If the Named Executive Officer s employment terminates due to the officer s death, disability or retirement, the performance stock units will be eligible to vest on a prorated basis based on the Company s performance over the three-year performance period. Unless otherwise provided by the Board of Directors, the performance stock units will also generally become fully vested upon a change in control of the Company.

The performance stock units granted to the Named Executive Officers during 2008 do not include any dividend rights.

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## OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

The following table presents information regarding the outstanding equity awards held by each of our Named Executive Officers as of December 31, 2008, including the vesting dates for the portions of these awards that had not vested as of that date.

| | Option Awards | | | | | Stock Awards | | | |
|---|---|---|---|---|---|---|---|---|---|
| Name (a) | Option Grant/ Award Date (b) | Number of Securities Underlying Unexercised Options Exercisable (#) (c) | Number of Securities Underlying Unexercised Options Unexercisable (#) (d) | Option Exercise Price ($) (e) | Option Expiration Date (f) | Number of Shares or Units of Stock That Have Not Vested (#) (g) | Market Value of Shares or Units of Stock That Have Not Vested ($)(1) (h) | Equity Incentive Plan Awards: Number of Unearned Shares, Units, or Other Rights That Have Not Vested (#) (i) | Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)(1) (j) |
| William S. Ayer | 5/25/99 | 33,100 | 0 | 39.6875 | 5/25/09 | 0 | 0 | 0 | 0 |
| | 1/25/00 | 40,100 | 0 | 30.50 | 1/25/10 | 0 | 0 | 0 | 0 |
| | 1/30/01 | 41,900 | 0 | 31.80 | 1/30/11 | 0 | 0 | 0 | 0 |
| | 11/12/01 | 39,000 | 0 | 25.20 | 11/12/11 | 0 | 0 | 0 | 0 |
| | 1/30/02 | 75,000 | 0 | 30.89 | 1/30/12 | 0 | 0 | 0 | 0 |
| | 5/31/02 | 75,000 | 0 | 27.85 | 5/31/12 | 0 | 0 | 0 | 0 |
| | 2/11/03 | 55,000 | 0 | 18.76 | 2/11/13 | 0 | 0 | 0 | 0 |
| | 3/1/04 | 30,700 | 0 | 26.10 | 3/1/14 | 0 | 0 | 0 | 0 |
| | 11/17/04 | 20,000 | 0 | 28.85 | 11/17/14 | 0 | 0 | 0 | 0 |
| | 8/30/05 | 34,575 | 11,525(2) | 32.96 | 8/30/15 | 0 | 0 | 0 | 0 |
| | 9/13/06 | 18,650 | 18,650(4) | 37.96 | 9/13/16 | 0 | 0 | 0 | 0 |
| | 1/31/07 | 5,950 | 17,850(5) | 42.85 | 1/31/17 | 5,200(5) | 152,100 | 10,500(6) | 307,125 |
| | 2/8/08 | 0 | 52,800(8) | 27.49 | 2/8/18 | 11,625(8) | 340,031 | 22,100(6) | 646,425 |
| Totals: | | 468,975 | 100,825 | | | 16,825 | 492,131 | 32,600 | 953,550 |
| Bradley D. Tilden | 5/25/99 | 8,400 | 0 | 39.6875 | 5/25/09 | 0 | 0 | 0 | 0 |
| | 1/25/00 | 11,600 | 0 | 30.50 | 1/25/10 | 0 | 0 | 0 | 0 |
| | 1/30/01 | 13,000 | 0 | 31.80 | 1/30/11 | 0 | 0 | 0 | 0 |
| | 11/12/01 | 15,600 | 0 | 25.20 | 11/12/11 | 0 | 0 | 0 | 0 |
| | 5/31/02 | 30,000 | 0 | 27.85 | 5/31/12 | 0 | 0 | 0 | 0 |
| | 2/11/03 | 15,000 | 0 | 18.76 | 2/11/13 | 0 | 0 | 0 | 0 |
| | 3/1/04 | 12,900 | 0 | 26.10 | 3/1/14 | 0 | 0 | 0 | 0 |
| | 8/30/05 | 9,675 | 3,225(2) | 32.96 | 8/30/15 | 0 | 0 | 0 | 0 |
| | 9/13/06 | 5,775 | 5,775(4) | 37.96 | 9/13/16 | 5,300(4) | 155,025 | 0 | 0 |
| | 1/31/07 | 3,075 | 9,225(5) | 42.85 | 1/31/17 | 3,200(5) | 93,600 | 5,400(6) | 157,950 |
| | 6/14/07 | 1,925 | 5,775(7) | 27.40 | 6/14/17 | 0 | 0 | 0 | 0 |
| | 2/8/08 | 0 | 27,400(8) | 27.49 | 2/8/18 | 6,300(8) | 184,275 | 11,500(6) | 336,375 |
| Totals: | | 126,950 | 51,400 | | | 14,800 | 432,900 | 16,900 | 494,325 |
| Glenn S. Johnson | 5/25/99 | 3,900 | 0 | 39.6875 | 5/25/09 | 0 | 0 | 0 | 0 |
| | 1/25/00 | 4,700 | 0 | 30.50 | 1/25/10 | 0 | 0 | 0 | 0 |
| | 1/30/01 | 6,000 | 0 | 31.80 | 1/30/11 | 0 | 0 | 0 | 0 |
| | 11/12/01 | 5,700 | 0 | 25.20 | 11/12/11 | 0 | 0 | 0 | 0 |
| | 5/31/02 | 7,500 | 0 | 27.85 | 5/31/12 | 0 | 0 | 0 | 0 |
| | 2/11/03 | 7,200 | 0 | 18.76 | 2/11/13 | 0 | 0 | 0 | 0 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 7/16/03 | 14,600 | 0 | 22.84 | 7/16/13 | 0 | 0 | 0 | 0 |
| | 3/1/04 | 7,000 | 0 | 26.10 | 3/1/14 | 0 | 0 | 0 | 0 |
| | 8/30/05 | 5,250 | 1,750(2) | 32.96 | 8/30/15 | 0 | 0 | 0 | 0 |
| | 1/12/06 | 0 | 0 | 0 | 1/12/16 | 1,000(3) | 29,250 | 0 | 0 |
| | 9/13/06 | 2,815 | 2,815(4) | 37.96 | 9/13/16 | 2,610(4) | 76,343 | 0 | 0 |
| | 1/31/07 | 1,245 | 3,735(5) | 42.85 | 1/31/17 | 1,090(5) | 31,883 | 1,090(6) | 31,883 |
| | 6/14/07 | 2,237 | 6,711(7) | 27.40 | 6/14/17 | 0 | 0 | 0 | 0 |
| | 2/8/08 | 0 | 21,900(8) | 27.49 | 2/8/18 | 5,100(8) | 149,175 | 9,200(6) | 269,100 |
| Totals: | | 68,147 | 36,911 | | | 9,800 | 286,651 | 10,290 | 300,983 |

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| | Option Awards | | | | | Stock Awards | | | |
|---|---|---|---|---|---|---|---|---|---|
| Name (a) | Option Grant/ Award Date (b) | Number of Securities Underlying Unexercised Options Exercisable (#) (c) | Number of Securities Underlying Unexercised Options Unexercisable (#) (d) | Option Exercise Price ($) (e) | Option Expiration Date (f) | Number of Shares or Units of Stock That Have Not Vested (#) (g) | Market Value of Shares or Units of Stock That Have Not Vested ($)(1) (h) | Equity Incentive Plan Awards: Number of Unearned Shares, Units, or Other Rights That Have Not Vested (#) (i) | Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)(1) (j) |
| Gregg A. Saretsky | 5/25/99 | 11,200 | 0 | 39.6875 | 5/25/09 | 0 | 0 | 0 | 0 |
| | 1/25/00 | 13,600 | 0 | 30.50 | 1/25/10 | 0 | 0 | 0 | 0 |
| | 1/30/01 | 15,500 | 0 | 31.80 | 1/30/11 | 0 | 0 | 0 | 0 |
| | 11/12/01 | 10,800 | 0 | 25.20 | 11/12/11 | 0 | 0 | 0 | 0 |
| | 5/31/02 | 3,590 | 0 | 27.85 | 1/5/12 | 0 | 0 | 0 | 0 |
| | 2/11/03 | 5,202 | 0 | 18.76 | 1/5/12 | 0 | 0 | 0 | 0 |
| | 3/1/04 | 13,500 | 0 | 26.10 | 1/5/12 | 0 | 0 | 0 | 0 |
| | 8/30/05 | 10,125 | 3,375(9) | 32.96 | 1/5/12 | 0 | 0 | 0 | 0 |
| | 9/13/06 | 5,775 | 5,775(9) | 37.96 | 1/5/12 | 5,300(9) | 155,025 | 0 | 0 |
| | 1/31/07 | 3,075 | 9,225(9) | 42.85 | 1/5/12 | 2,700(9) | 78,975 | 3,600(6) | 105,300 |
| | 6/14/07 | 1,925 | 5,775(9) | 27.40 | 1/5/12 | 0 | 0 | 0 | 0 |
| | 2/8/08 | 0 | 21,900(9) | 27.49 | 1/5/12 | 5,100(9) | 149,175 | 3,067(6) | 89,710 |
| Totals: | | 94,292 | 46,050 | | | 13,100 | 432,900 | 6,667 | 195,010 |
| Jeffrey D. Pinneo | 5/25/99 | 3,900 | 0 | 39.6875 | 5/25/09 | 0 | 0 | 0 | 0 |
| | 1/25/00 | 4,700 | 0 | 30.50 | 1/25/10 | 0 | 0 | 0 | 0 |
| | 1/30/01 | 6,000 | 0 | 31.80 | 1/30/11 | 0 | 0 | 0 | 0 |
| | 11/12/01 | 2,700 | 0 | 25.20 | 11/12/11 | 0 | 0 | 0 | 0 |
| | 5/31/02 | 30,000 | 0 | 27.85 | 5/31/12 | 0 | 0 | 0 | 0 |
| | 2/11/03 | 12,000 | 0 | 18.76 | 2/11/13 | 0 | 0 | 0 | 0 |
| | 3/1/04 | 10,800 | 0 | 26.10 | 3/1/14 | 0 | 0 | 0 | 0 |
| | 8/30/05 | 8,100 | 2,700(2) | 32.96 | 8/30/15 | 0 | 0 | 0 | 0 |
| | 9/13/06 | 4,890 | 4,890(4) | 37.96 | 9/13/16 | 4,490(4) | 131,333 | 0 | 0 |
| | 1/31/07 | 2,600 | 7,800(5) | 42.85 | 1/31/17 | 2,300(5) | 67,275 | 4,6006) | 134,550 |
| | 2/8/08 | 0 | 18,500(8) | 27.49 | 2/8/18 | 4,400(8) | 128,700 | 7,800(6) | 228,150 |
| Totals: | | 85,690 | 36,911 | | | 11,190 | 327,308 | 12,400 | 362,700 |

(1) The dollar amounts shown in Column (h) and Column (j) are determined by multiplying the number of shares or units reported in Column (g) and Column (i), respectively, by $29.25 (the closing price of our common stock on the last trading day of fiscal 2008).

(2) The unvested options under the 8/30/05 grant will become fully vested on 8/30/09.

(3) The RSUs awarded to Mr. Johnson on 1/12/06 vested on 1/12/09.

(4) The RSUs awarded on 9/13/06 will become fully vested on 9/13/09, except for Mr. Saretsky as noted below. The unvested options under the 9/13/06 grant will become vested as follows: Mr. Ayer 9,325 on 9/13/09 and 9,325 on 9/13/10; Mr. Tilden 2,887 on 9/13/09 and 2,888 on 9/13/10; Mr. Johnson 1,407 on 9/13/09 and 1,408 on 9/13/10; and Mr. Pinneo 2,445 on 9/13/09 and 2,445 on 9/13/10.

(5) The RSUs awarded on 1/31/07 will become fully vested on 1/31/2010, except for Mr. Saretsky as noted below. The unvested options under the 1/31/07 grant will become vested as follows: Mr. Ayer 5,950 on 1/31/09, 5,950 on 1/31/10 and 5,950 on 1/31/11; Mr. Tilden 3,075 on 1/31/09, 3,075 on 1/31/10 and 3,075 on 1/31/11; Mr. Johnson 1,245 on 1/31/09, 1,245 on 1/31/10 and 1,245 on 1/31/11; and Mr. Pinneo 2,600 on 1/31/09, 2,600 on 1/31/10 and 2,600 on 1/31/11.

(6) The performance stock units reported in Column (i) are eligible to vest based on the Company s performance over a three-year period as described in the Compensation Discussion and Analysis section above. Mr. Saretsky resigned effective December 31, 2008. As such, he is only eligible to receive two-thirds of his 2007 Performance Share Unit grants and one-third of his 2008 Performance Share Unit grants if the targets are met.

(7) The unvested options under the 6/14/07 grant will become vested as follows: Mr. Tilden 1,925 on 6/14/09, 1,925 on 6/14/10 and 1,925 on 6/14/11; and Mr. Johnson 2,237 on 6/14/09, 2,237 on 6/14/10 and 2,237 on 6/14/11.

(8)

The RSUs awarded on 2/8/08 will become fully vested on 2/8/2011, except for Mr. Saretsky as noted below. The unvested options under the 2/8/08 grant will become vested as follows: Mr. Ayer 13,200 on 2/8/09, 13,200 on 2/28/10, 13,200 on 2/8/11, and 13,200 on 2/8/12; Mr. Tilden 6,850 on 2/8/09, 6,850 on 2/8/10, 6,850 on 2/8/11, and 6,850 on 2/8/12; Mr. Johnson 5,475 on 2/8/09, 5,475 on 2/8/10, 5,475 on 2/8/11, and 5,475 on 2/8/12; and Mr. Pinneo 4,625 on 2/8/09, 4,625 on 2/8/10, 4,625 on 2/8/11, and 4,625 on 2/8/12.

(9) As noted previously, Mr. Saretsky resigned effective 12/31/08. As part of his separation agreement, all of his outstanding option awards and restricted stock units fully vested as of 1/5/09 and will expire 1/5/12.

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## 2008 OPTION EXERCISES AND STOCK VESTED

The following table presents information regarding the exercise of stock options by Named Executive Officers during 2008, and on the vesting during 2008 of other stock awards previously granted to the Named Executive Officers.

| | Option Awards | | Stock Awards | |
|---|---|---|---|---|
| **Name (a)** | **Number of Shares Acquired on Exercise (#) (b)** | **Value Realized on Exercise ($) (c)** | **Number of Shares Acquired on Vesting (#) (d)** | **Value Realized on Vesting ($) (1) (e)** |
| William S. Ayer | 0 | 0 | 14,000 | 294,140 |
| Bradley D. Tilden | 0 | 0 | 5,350 | 112,404 |
| Glenn S. Johnson | 0 | 0 | 6,230 | 130,892 |
| Gregg A. Saretsky | 0 | 0 | 5,570 | 117,026 |
| Jeffrey D. Pinneo | 0 | 0 | 4,870 | 102,319 |

(1) The dollar amounts shown in Column (e) above for stock awards are determined by multiplying the number of shares or units, as applicable, that vested by the per-share closing price of our common stock on the vesting date.

## 2008 PENSION BENEFITS

### Pension and Other Retirement Plans

The Company maintains two primary defined benefit pension plans covering the Named Executive Officers. The Alaska Air Group, Inc. Retirement Plan for Salaried Employees (the Salaried Retirement Plan ) is our qualified defined benefit employee retirement plan, and the Named Executive Officers participate in this plan on the same general terms as our other eligible employees. The Named Executive Officers also participate in the Alaska Air Group, Inc. 1995 Elected Officers Supplementary Retirement Plan (the Supplementary Retirement Plan ).

The following table presents information regarding the present value of accumulated benefits that may become payable to the Named Executive Officers under our qualified and nonqualified defined-benefit pension plans.

| **Name (a)** | **Plan Name (b)** | **Number of Years Credit Service (#)(1) (c)** | **Present Value of Accumulated Benefit ($)(1) (d)** | **Payments During Last Fiscal Year ($) (e)** |
|---|---|---|---|---|
| William S. Ayer | Salaried Retirement Plan | 13.308 | 419,555 | 0 |
| | Supplementary Retirement Plan | 13.398 | 1,682,905 | 0 |
| Bradley D. Tilden | Salaried Retirement Plan | 17.844 | 392,122 | 0 |
| | Supplementary Retirement Plan | 9.919 | 597,637 | 0 |
| Glenn S. Johnson | Salaried Retirement Plan | 14.144 | 335,546 | 0 |
| | Supplementary Retirement Plan | 5.431 | 670,398 | 0 |
| Gregg A. Saretsky(2) | Salaried Retirement Plan | 10.771 | 251,368 | 0 |
| | Supplementary Retirement Plan | 10.771 | 531,276 | 0 |
| Jeffrey D. Pinneo | Salaried Retirement Plan | 3.816 | 20,304 | 0 |
| | Supplementary Retirement Plan | 6.920 | 1,086,298 | 0 |

(1) The years of credited service and present value of accumulated benefits shown in the table above are presented as of December 31, 2008 assuming that each Named Executive Officer retires at normal retirement age and that benefits are paid

out in accordance with the terms of each plan described below. For a

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description of the material assumptions used to calculate the present value of accumulated benefits shown above, please see Note 8 (Employee Benefits Plans) to the Company s Consolidated Financial Statements, included as part of the Company s 2008 Annual Report filed on Form 10-K with the SEC and incorporated herein by reference.

(2) Mr. Saretsky resigned effective December 31, 2008. As part of his Separation Agreement, Mr. Saretsky will be paid $275,000 on January 31, 2009 and $275,000 on January 1, 2010 for his accrued benefits in the Supplemental Retirement Plan. Mr. Saretsky will no longer accrue benefits under the Salaried Retirement Plan subsequent to December 31, 2008.

### *Salaried Retirement Plan*

The Salaried Retirement Plan is a tax-qualified, defined-benefit retirement plan for salaried Alaska Airlines employees hired prior to April 1, 2003, in which all of the Named Executive Officers participate. Each of our Named Executive Officers is fully vested in his accrued benefits under the Salaried Retirement Plan. Benefits payable under the Salaried Retirement Plan are generally based on years of credited service with the Company and its affiliates and final average base salary for the five highest complete and consecutive calendar years of an employee s last ten complete calendar years of service. The annual retirement benefit at age 62 (normal retirement age under the Salaried Retirement Plan) is equal to 2% of the employee s final average base salary times years of credited service (limited to 40 years). Annual benefits are computed on a straight life annuity basis beginning at normal retirement age. Benefits under the Salaried Retirement Plan are not subject to offset for Social Security benefits.

The tax law limits the compensation on which annual retirement benefits are based. For 2008, this limit was $230,000. The tax law also limits the annual benefits that may be paid from a tax-qualified retirement plan. For 2008, this limit on annual benefits was $185,000.

### *Supplementary Retirement Plan*

In addition to the benefits described above, the Named Executive Officers are eligible to receive retirement benefits under the Supplementary Retirement Plan. The Supplementary Retirement Plan is a non-qualified, unfunded, defined-benefit plan. Normal retirement benefits are payable once the officer reaches age 60. Benefits are calculated as a monthly amount on a straight life annuity basis. In general, the monthly benefit is determined as a percentage (between 50% to 75% of a participant s final average monthly base salary) with the percentage determined based on both the officer s length of service with the Company and length of service as an elected officer. This benefit amount is subject to offset by the amount of the officer s Social Security benefits and the amount of benefits paid under the Salaried Retirement Plan to the extent such benefits were accrued after the officer became a participant in the Supplementary Retirement Plan. (There is no offset for any Salaried Retirement Plan benefits accrued for service before the officer became a participant in the Supplementary Retirement Plan.)

Participants in the Supplementary Retirement Plan become fully vested in their benefits under the plan upon attaining age 50 and completing 10 years of service as an elected officer. Plan benefits will also become fully vested upon a change of control of the Company or upon termination of the participant s employment due to death or disability.

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## 2008 NONQUALIFIED DEFERRED COMPENSATION

Under the Deferred Compensation Plan, the Named Executive Officers and other key employees may elect to receive a portion of some or all of their Performance-Based Pay awards on a deferred basis. For 2008, amounts deferred under the Deferred Compensation Plan were credited with interest at a rate of 6.5%. This rate (as in prior years) is based on the mean between the high and the low rates during the first 11 months of the preceding year of yields of Ba2-rated industrial bonds as determined by the plan administrator (rounded to the nearest one-quarter of one percent). Participants under the plan have the opportunity to elect among the investment funds offered under our 401(k) plan for purposes of determining the return on their plan accounts. Alternatively, participants may allocate some or all of their plan account to an interest-bearing option with a rate equal to the yield on a Moody s index of Ba2-rated industrial bonds as of November of the preceding year, rounded to the nearest one-quarter of one percent. Subject to applicable tax laws, amounts deferred under the plan are generally distributed on termination of the participant s employment, although participants may elect an earlier distribution date and/or may elect payment in a lump sum or installments.

The following table presents information regarding the contributions to and earnings on the Named Executive Officers balances under the Company s nonqualified defined contribution plans during 2008, and also shows the total deferred amounts for the Named Executive Officers as of December 31, 2008.

| Name (a) | Executive Contributions in Last FY ($) (b) | Registrant Contributions in Last FY ($) (c) | Aggregate Earnings in Last FY ($)(1) (d) | Aggregate Withdrawals/ Distributions ($) (e) | Aggregate Balance at Last FYE ($)(1) (f) |
|---|---|---|---|---|---|
| William S. Ayer | 76,320 | 0 | 5,235 | 26,298 | 275,594 |
| Bradley D. Tilden | 0 | 0 | 0 | 0 | 0 |
| Glenn S. Johnson | 35,471 | 0 | 27,351 | 37,726 | 563,805 |
| Gregg A. Saretsky | 0 | 0 | 2,847 | 6,127 | 44,969 |
| Jeffrey D. Pinneo | 0 | 0 | (1,048) | 1,028 | 6,018 |

(1) Only the portion of earnings on deferred compensation that is considered to be at above-market rates under SEC rules is included as compensation for each Named Executive Officer in Column (h) of the Summary Compensation Table. Total earnings for each Named Executive Officer listed in Column (d) above were also included as earnings in the Summary Compensation Table.

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### Potential Payments Upon Change in Control and Termination

Under the change in control agreements in place with our Named Executive Officers, if a change of control occurs, a three- year employment period would go into effect. During the employment period, the executive would be entitled to:

- receive the highest monthly salary the executive received at any time during the 12-month period preceding the change in control;
- receive an annual incentive payment equal to the higher of the executive s target Performance-Based Pay plan incentive or the average of his annual incentive payments for the three years preceding the year in which the change in control occurs;
- continue to accrue age and service credit under our qualified and non-qualified defined benefit retirement plans; and
- participate in fringe benefit programs that are at least as favorable as those in which the executive was participating prior to the change in control.

If the executive s employment is terminated by the Company without cause or by the executive for good reason during the employment period (or, in certain circumstances, if such a termination occurs prior to and in connection with a change in control), the executive would be entitled to receive a lump sum payment equal to the value of the payments and benefits identified above that the executive would have received had he continued to be employed for the entire employment period. (The terms cause, good reason and change in control are each defined in the change in control agreements.) In the event that the executive s benefits under the agreement are subject to the excise tax imposed under Section 280G of the Internal Revenue Code, the Company will make a tax payment to the executive so that the net amount of such payment (after taxes) he receives is sufficient to pay the excise tax due.

In addition, outstanding and unvested stock options, restricted stock units and the target number of performance stock units would become vested under the terms of our equity plans. In the case of awards granted under our 2004 Long-Term Incentive Equity Plan, unless the Board determined otherwise, the awards would vest upon a change in control irrespective of a termination of employment. Under our 2008 Performance Incentive Plan, awards will not vest unless a termination of employment without cause or for good reason also occurs or an acquirer does not assume outstanding awards. Finally, the executive s unvested benefits under the Supplementary Retirement Plan would vest on a change in control whether or not the executive s employment was terminated. The outstanding equity awards held by the executives as of December 31, 2008 are described above under Outstanding Equity Awards at Fiscal Year End and each executive s accrued benefits under our retirement plans are described above under 2008 Pension Benefits,

In the table below, we have estimated the potential cost to us of the payments and benefits each Named Executive Officer would have received if his employment had terminated under the circumstances described above on December 31, 2008. As described above, except for the equity acceleration value, the amount an executive would be entitled to receive would be reduced pro-rata for any period the executive actually worked during the employment period. Mr. Saretsky is excluded from the table as his resignation was effective December 31, 2008.

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| | Cash Severance(1) | Enhanced Retirement Benefit(2) | Benefit Continuation(3) | Equity Acceleration(4) | Excise Tax Gross-Up(5) | Total |
|---|---|---|---|---|---|---|
| William S. Ayer | $ 2,160,000 | $ 20,700 | $ 193,191 | $ 1,538,609 | $ 1,272,278 | $ 5,148,778 |
| Bradley D. Tilden | $ 1,646,709 | $ 311,472 | $ 282,813 | $ 986,133 | $ 1,165,722 | $ 4,392,848 |
| Glenn S. Johnson | $ 1,524,291 | $ 537,400 | $ 204,175 | $ 638,592 | $ 1,141,584 | $ 4,046,042 |
| Jeffrey D. Pinneo | $ 1,244,250 | $ 234,195 | $ 203,433 | $ 722,568 | $ 816,091 | $ 3,220,537 |

(1) Represents the amount obtained by multiplying three by the sum of the executive s highest rate of base salary during the preceding 12 months and the higher of the executive s target incentive or his average incentive for the three preceding years.

(2) Represents the sum of (a) the actuarial equivalent of an additional three years of age and service credit under our qualified and non-qualified retirement plan using the executive s highest rate of salary during the preceding 12-months prior to a change in control, (b) the present value of the accrued but unvested portion of the non-qualified retirement benefits that would vest upon a change of control, and (c) the matching contribution the executive would have received under our qualified defined contribution plan had the executive continued to contribute the maximum allowable amount during the employment period.

(3) Represents the estimated cost of (a) 18 months of premiums under our medical, dental, life, disability, and accidental death insurance programs and (b) three years of continued participation in life, disability, accidental death insurance and other fringe benefit programs.

(4) Represents the in-the-money value of unvested stock options and the face value of unvested restricted stock and performance stock unit awards that would vest upon a change of control based on a stock price of $29.25 (the closing price of our stock on the last trading day of fiscal 2008).

(5) For purposes of this calculation, we have assumed that the executive s outstanding stock options would be assumed by the acquiring company pursuant to a change in control.

This calculation is an estimate for proxy disclosure purposes only. Payments on an actual change in control may differ based on factors such as transaction price, timing of employment termination and payments, methodology for valuing stock options, changes in compensation, and reasonable compensation analyses.

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## PROPOSAL NO. 4

## STOCKHOLDER PROPOSAL

John Chevedden has given notice of his intention to present a proposal at the 2009 Annual Meeting. Mr. Chevedden s address is 2215 Nelson Avenue, No. 205, Redondo Beach, CA 90278, and Mr. Chevedden represents that he has owned no less than 200 shares of the Company s common stock since July 1, 2006. Mr. Chevedden s proposal and supporting statement, as submitted to the Company, appear below in italics.

The Board of Directors opposes adoption of Mr. Chevedden s proposal and asks stockholders to review the Board s response, which follows Mr. Chevedden s proposal and supporting statement below.

The affirmative vote of the holders of a majority of the shares of common stock present in person or represented by proxy at the meeting, and entitled to vote on the proposal, is required to approve this proposal.

**STOCKHOLDER PROPOSAL NO. 4**

**SPECIAL SHAREOWNER MEETINGS**

*RESOLVED, shareowners ask our board to take the steps necessary to amend our bylaws and each appropriate governing document to give holders of 10% of our outstanding common stock (or the lowest percentage allowed by law above 10%) the power to call special shareowner meetings. This includes that such bylaw and/or charter text will not have any exception or exclusion conditions (to the fullest extent permitted by state law) that apply only to shareowners but not to management and/or the board.*

***Statement of John Chevedden***

*Special meetings allow shareowners to vote on important matters, such as electing new directors, that can arise between annual meetings. If shareowners cannot call special meetings, management may become insulated and investor returns may suffer. Shareowners should have the ability to call a special meeting when a matter is sufficiently important to merit prompt consideration.*

*Fidelity and Vanguard supported a shareholder right to call a special meeting. Governance ratings services, including The Corporate Library and Governance Metrics International, took special meeting rights into consideration when assigning company ratings.*

*This proposal topic won impressive support at the following companies (based on 2008 yes and no votes):*

*Occidental Petroleum (OXY) 66% Emil Rossi (Sponsor)*

*First Energy Corp. (FE) 67% Chris Rossi*

*Marathon Oil (MRO) 69% Nick Rossi*

*The merits of this Special Shareowner Meetings proposal should also be considered in the context of the need for further improvements in our company s corporate governance and in individual director performance. In 2008 the following governance and performance issues were identified:*

*We had no shareholder right to:*

- *Cumulative voting*
- *Call a special meeting*
- *Act by written consent*
- *An Independent Chairman*
- *Or even a Lead Director*

*Our management should show that it has the leadership initiative to adopt the above Board accountability items instead of leaving it to shareholders to take the initiative in proposing such improvements.*

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*Our Board failed to adopt two shareholder proposals which won majority vote at our 2008 annual meeting:*

*Cumulative Voting (51% support)*

*Our Company will take three years to transition to annual election of each director when the transition could have been completed in one year.*

*Our full board met only six times in a year.*

*Only 49% of CEO pay was incentive based.*

*The voting figures at our 2007 annual meeting were withheld from shareholders for two months except for certain privileged shareholders.*

*Two directors had 17 to 26-years tenure (independence concern) and constituted 50% of our key nomination committee including the chairmanship:*

*Marc Langland*

*Byron Mallott*

*The Alaska Air board was the only significant directorship for six of our nine directors:*

*Byron Mallott*

*Mark Hamilton*

*Marc Langland*

*Dennis Madsen*

*Patricia Bedient*

*Jessie Knight*

*The above concerns show there is need for improvement. Please encourage our board to respond positively to this proposal.*

***Special Shareowner Meetings***

***Yes on 4***

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE AGAINST PROPOSAL 4 FOR THE FOLLOWING REASONS:**

The Board believes that it is not in the interest of the Company and its stockholders to incur the financial and administrative expense and business disruption that would result from enabling a minority of stockholders to call stockholder meetings for any reason, at any time and as frequently as they choose.

The Board s annual meeting of stockholders already provides ample opportunity to raise appropriate matters. Stockholders have frequently used the stockholder meetings to have their concerns communicated to the whole of the Company s stockholders, including through proposals such as this Proposal. For those extraordinary circumstances where a matter cannot wait until the next annual meeting, the Company s Bylaws, consistent with Delaware law, permit a majority of Directors or a Chairman of the Board to call a special meeting. The Board, rather than a group of minority stockholders, is best positioned to determine when it is in the interest of the stockholders as a whole to incur the extraordinary financial and administrative expense of holding a special meeting.

Allowing minority groups of stockholders to call meetings at will could also create major confusion. Different groups of stockholders could call meetings at any time on various matters. This could lead to significant confusion among the majority of the stockholders because stockholders would receive materials from multiple groups of stockholders at various points throughout the year requesting votes on a range of issues, some of which may be in part duplicative, rather than through the streamlined annual meeting process currently in place. Constant solicitation could lead to a chaotic rather than orderly conduct of corporate affairs, and may annoy the majority of stockholders and lead to less overall participation by stockholders of the Company in important matters.

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Constant solicitation would also impose significant administrative and financial burdens on the Company. Special meetings are costly in terms of both time and money. Each stockholder of record would be entitled to notice of, and to receive proxy materials for, every special meeting. This would involve legal, printing, postage and other expenses, in addition to those costs normally associated with the Company s

Annual Meeting. These costs would arise every time there was a new solicitation. In addition, preparing for a stockholder meeting requires significant attention from management and other employees, diverting them from running and improving the business.

Because special meetings are costly and can be disruptive, the Board believes they should not be taken lightly. The Board believes the Company s current system minimizes this confusion and prevents a minority of stockholders from imposing upon the Company at will the burden and expense of a stockholder meeting that may not be desired by the majority of stockholders.

**ACCORDINGLY, THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE AGAINST PROPOSAL 4.**

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## PARTICIPANTS IN THE SOLICITATION

The following information is being provided pursuant to SEC regulations that require certain disclosures if the Company references a solicitation in opposition.

Under the SEC regulations, each member of the Board of Directors is deemed to be a Participant in the Company s solicitation of proxies in connection with the 2009 Annual Meeting. Set forth below are the name and principal occupation of each member of the Board (six of whom are also nominees), and the name, principal business and address of any corporation or other organization in which that director s occupation or employment is carried on. For additional information concerning each of the directors, see Nominees for Election and Continuing Directors in this Proxy Statement.

| Name and Principal Occupation | Business Address | Principal Business of Employer |
|---|---|---|
| William S. Ayer<br><br>Chairman, President and CEO | Alaska Air Group, Inc. and<br><br>Alaska Airlines, Inc.<br><br>P.O. Box 68900<br><br>Seattle, WA 98168 | Air transportation |
| Patricia M. Bedient<br><br>Executive Vice President and CFO | Weyerhaeuser Company<br><br>33663 Weyerhaeuser Way So.<br><br>Federal Way, WA 98003 | Forest products |
| Phyllis J. Campbell<br><br>Chair, Pacific Northwest Region | JPMorgan Chase and Company | Banking |
| Mark R. Hamilton<br><br>President | University of Alaska System<br><br>202 Butrovich Bldg.<br><br>910 Yukon Drive<br><br>Fairbanks, AK 99775 | Education |
| Jessie J. Knight, Jr.<br><br>Executive Vice President, External Affairs | Sempra Energy<br><br>101 Ash Street<br><br>San Diego, CA 92101 | Energy |
| R. Marc Langland<br><br>Chairman, President and CEO | Northrim Bank<br><br>P.O. Box 241489<br><br>Anchorage, AK 99524 | Banking |
| Dennis F. Madsen | Pivotlink Software | Software |

| | | |
|---|---|---|
| Chairman | 15325 SE 30th Place<br>Bellevue, WA 98007 | |
| Byron I. Mallott<br>Senior Fellow | First Alaskans Institute<br>102 Cordova<br>Juneau, AK 99801 | Development of Alaska Native peoples and their communities |
| J. Kenneth Thompson<br>President and CEO | Pacific Star Energy LLC<br>1120 Huffman Rd., Suite 24<br>Anchorage, AK 99515 | Energy |

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### Other Participants

The following employees of the Company may also be deemed to be Participants. The principal business address of each is that of the Company, P.O. Box 68947, Seattle, WA 98168.

*Shannon K. Alberts*

Managing Director, Investor Relations and Assistant Secretary of Alaska Airlines, Inc. and Assistant Secretary of Alaska Air Group, Inc.

*Karen A. Gruen*

Managing Director, Corporate Affairs, Associate General Counsel and Assistant Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc.

*Glenn S. Johnson*

Executive Vice President, Finance and CFO of Alaska Air Group, Inc. and Alaska Airlines, Inc.

*Keith Loveless*

Vice President, Legal and Corporate Affairs, General Counsel and Corporate Secretary of Alaska Air Group, Inc. and Alaska Airlines, Inc.

*Brandon S. Pedersen*

Vice President, Finance and Controller of Alaska Air Group, Inc. and Alaska Airlines, Inc.

### Information Regarding Ownership of the Company s Securities by Participants

The number of shares of common stock beneficially owned by each director and Mr. Johnson at March 20, 2009 is set forth in the Security Ownership of Certain Beneficial Owners and Management section of this Proxy Statement. On March 20, 2009, Ms. Alberts, Ms. Gruen, Mr. Loveless and Mr. Pedersen beneficially owned , , shares, and shares respectively, of which , and shares, respectively, were shares that may be acquired by exercise of employee stock options exercisable on or before May 19, 2009. No Associate (as that term is used in SEC regulations) of a Participant owns any common stock of the Company. No Participant owns any securities of any parent or subsidiary of the Company beneficially, either directly or indirectly. No Participant or Associate of any Participant owns shares of record that are not also owned beneficially.

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### Information Regarding Transactions in the Company s Stock by Participants

The following table sets forth all transactions that may be deemed purchases or sales of the Company s common stock by the Participants since January 1, 2007.

| Participants | Date | Number of Shares of Common Stock Purchased or (Sold/ Exchanged) | Footnote |
|---|---|---|---|
| Shannon K. Alberts | | | |
| William S. Ayer | | | |
| Patricia M. Bedient | | | |
| Phyllis J. Campbell | | | |
| Karen A. Gruen | | | |
| Mark R. Hamilton | | | |
| Glenn S. Johnson | | | |
| Jessie J. Knight, Jr. | | | |
| R. Marc Langland | | | |
| Keith Loveless | | | |
| Dennis F. Madsen | | | |
| Byron I. Mallott | | | |
| Brandon S. Pedersen | | | |
| J. Kenneth Thompson | | | |

(1) Total of quarterly investments in ALK common shares in the Company s 401(k) plan at year end.

(2) Transfer of ALK common shares within the Company s 401(k) plan.

(3) Common shares acquired upon exercise of employee stock option.

(4) Common shares purchased (sold) through the Company s Employee Stock Purchase Plan.

(5) Director retainer paid in common stock.

(6) Same-day exercise and sale of employee stock option.

(7) Issue of common shares in lieu of cash bonus under employee stock option plan.

(8) Restricted stock units vested and issued; no longer subject to forfeiture.

### Understandings with Respect to Securities of the Company

In 2008, non-employee directors received 70% of their annual retainers for service as directors in the form of deferred stock units. The units are fully vested but will not be issued until the director ceases to serve on the Board of Directors. See 2008 Director Compensation in this Proxy Statement.

As of March 20, 2009, the following Participants have employee stock options [outstanding?] for the indicated number of shares of common stock: Ms. Alberts, ; Mr. Ayer, ; Ms. Gruen, ; Mr. Johnson, ; Mr. Loveless, and Mr. Pedersen, . See the Information Regarding Transactions in the Company s Stock by Participants table in this Proxy Statement for additional information.

Except as described in this Proxy Statement, no Participant has and during the last year has not had any arrangement or understanding with any person with respect to any securities of the Company.

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### Understandings with Respect to Future Employment by the Company

Messrs. Ayer, Johnson, Loveless and Pedersen have agreements with the Company under which they would receive severance pay for up to 36 months in the event that they were terminated within 36 months after a change in control of the Company.
Ms. Alberts and Ms. Gruen have an agreement with the Company under which they would receive severance pay for up to 24 months in the event that they are terminated within 24 months after a change in control. See Potential Payments Upon Change in Control in this Proxy Statement. No other Participant, nor any Associate of any Participant, has any understanding with respect to future employment. No Participant or any Associate of any Participant has any arrangement or understanding with respect to future transactions to which the Company or any of its affiliates will or may be a party.

## REDUCE DUPLICATIVE MAILINGS

The Company is required to provide an annual report and proxy statement to all stockholders of record. If you have more than one account in your name or at the same address as other stockholders, the Company or your broker may discontinue mailings of multiple copies. If you wish to receive separate mailings for multiple accounts at the same address, you should mark the designated box on your proxy card. If you are voting by telephone or the internet and you wish to receive multiple copies, you may notify us at the address and phone number at the end of the following paragraph if you are a stockholder of record or notify your broker if you hold through a broker.

Once you have received notice from your broker or us that they or we will discontinue sending multiple copies to the same address, you will receive only one copy until you are notified otherwise or until you revoke your consent. If, at any time, you wish to resume receiving separate proxy statements or annual reports, or if you are receiving multiple statements and reports and wish to receive only one, please notify your broker if your shares are held in a brokerage account or us if you hold registered shares. You can notify us by sending a written request to the Company s Corporate Secretary, Alaska Air Group, Inc., P.O. Box 68947, Seattle, WA 98168, or by calling (206) 392-5131.

## SUBMISSION OF PROPOSALS FOR NEXT ANNUAL MEETING

The Company expects to hold its next annual meeting on or about May 18, 2010. If you wish to submit a proposal for inclusion in the proxy materials for that meeting, you must send the proposal to the Corporate Secretary at the address below. The proposal must be received at the Company s executive offices no later than November 30, 2009, to be considered for inclusion. Among other requirements set forth in the SEC s proxy rules and the Company s Bylaws, you must have continuously held at least $2,000 in market value or 1% of the Company s outstanding stock for at least one year by the date of submitting the proposal, and you must continue to own such stock through the date of the meeting.

If you intend to nominate candidates for election as directors or present a proposal at the meeting without including it in the Company s proxy materials, you must provide notice of such proposal to the Company no later than February 18, 2010 The Company s Bylaws outline procedures for giving the required notice. If you would like a copy of the procedures contained in our Bylaws, please contact:

Corporate Secretary

Alaska Air Group, Inc.

P.O. Box 68947

Seattle, WA 98168

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**Exhibit A**

**CHARTER OF THE AUDIT COMMITTEE**

**OF THE BOARD OF DIRECTORS**

**OF ALASKA AIR GROUP, INC.**

**As Amended December 5, 2008**

**1. Purpose.**

There shall be a committee of the Board of Directors to be known as the Audit Committee. The purpose of the Audit Committee is to assist the Board of Directors of Alaska Air Group, Inc. (the Company ) in overseeing the accounting and financial reporting processes of the Company and audits of the financial statements of the Company, including:

(a) the integrity of the Company s financial statements and the reliability of the Company s financial information reported to the public,

(b) the Company s compliance with legal and regulatory requirements,

(c) the qualifications and independence of the Company s independent accountants,

(d) the adequacy of the Company s internal controls and financial risk management function, and

(e) such other matters as may be assigned by the Board of Directors.

While the Audit Committee has the responsibilities and powers set forth in this charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company s financial statements are complete and accurate or in accordance with generally accepted accounting principles. This is the responsibility of management and the independent auditors.

**2. Composition.**

The Audit Committee shall be appointed by the Board of Directors and shall have at least three members. All members of the Audit Committee shall meet the independence, financial literacy and experience requirements of the New York Stock Exchange, as the same may be amended or supplemented from time to time, and of the Securities and Exchange Commission (the SEC ) pursuant to regulations promulgated by the SEC under The Sarbanes-Oxley Act of 2002 (the Sarbanes Act ) or otherwise, as the same may be amended or supplemented from time to time. The Company must disclose in its periodic reports required by Section 13(a) of the Securities Exchange Act of 1934 (the Act ) whether or not it has at least one member who is a financial expert, as defined by the SEC pursuant to the Sarbanes Act and whether such expert is independent as defined in Section 10A(m)(3) of the Act, and if not, why not.

**3. Matters Pertaining to Independent Accountants.**

The Audit Committee shall be solely responsible for the appointment, compensation and oversight of the work of the Company s independent accountants (including resolution of disagreements between management and the independent accountants regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and, where appropriate, the determination to terminate and replace such firm. Such independent accountants shall report directly to and be ultimately accountable to the Audit Committee.

The Audit Committee shall:

(a) Review the terms of the engagement of the independent accountants, including the scope of their audit, proposed fees and personnel qualifications.

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(b) Obtain and review from the independent accountants at least annually a formal written statement regarding:

(1) the independent accountants internal quality-control procedures;

(2) any material issues raised by the most recent internal quality control review, or peer review, of the independent accountants, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the independent accountants, and any steps taken to deal with any such issues; and

(3) all relationships between the independent accountants and the Company.

(c) Actively engage in a dialogue with the independent accountants with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent accountants, and recommend that the Board of Directors take appropriate action to satisfy itself of such independence.

(d) Pre-approve all auditing services and all non-auditing services to be performed by the independent accountants. Such pre-approval may be given as part of the Audit Committee s approval of the scope of the engagement of the independent accounts or on an individual basis.

The approved non-auditing services must be disclosed in the Company s periodic public reports required by Section 13(a) of the Act and the fees paid by the Company for such non-auditing services must be disclosed in the Company s annual proxy statement pursuant to Item 9(e) of Regulation 14A promulgated under the Act. The pre-approval of non-auditing services can be delegated by the Audit Committee to one or more of its members, but the decision must be presented to the full Audit Committee at the next scheduled meeting.

The independent accountants shall not be retained to perform the non-audit functions prohibited by Section 10A(g) of the Act.

(e) Establish clear hiring policies for employees and former employees of the independent accountants.

(f) Review the Company s annual audited financial statements and quarterly financial statements with management and the independent accountants (including the Company s disclosure under Management s Discussion and Analysis of Financial Condition and Results of Operations). The Chair of the Audit Committee may represent the entire Audit Committee for purposes of the review of quarterly statements.

(g) Receive and review required communications from the independent accountants, including: (a) any items required to be communicated by the independent accountants in accordance with AICPA Statement of Auditing Standards ( SAS ) 61, (b) if applicable, any audit problems or difficulties and management s response; and (c) timely reports regarding the following matters in connection with any audits performed by the Company s independent accountants:

(1) all critical accounting policies and practices to be used;

(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the Company, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent accountant; and

(3) other material written communications between the independent accountant and the Company s management, such as any management letter or schedule of unadjusted differences.

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**4. Matters Pertaining to the Internal Auditor.**

The Audit Committee shall:

(a) Review and approve the annual internal audit plan, ensuring the application of an appropriate risk-based methodology that satisfactorily monitors the Company s highest risk areas.

(b) Discuss with the Internal Audit Executive the results of internal audit activities, special reviews, investigations, or projects, with specific attention to any significant deficiencies in the design or operation of the Company s internal controls or any fraud (regardless of materiality) involving persons having a significant role in internal controls.

(c) Annually review the structure and resources of the audit team, including staffing adequacy and other factors that may affect the effectiveness and timeliness of the internal audits.

(d) Review and approve any changes to the internal audit charter.

**5. Matters Pertaining to Filings with Government Agencies.**

The Audit Committee shall prepare the report required by the rules of the Securities and Exchange Commission to be included in the Company s annual proxy statement to shareholders.

**6. Controls.**

The Audit Committee shall:

(a) Review with management the Company s major financial risk exposure and the adequacy and effectiveness of the Company s associated internal controls.

(b) Review the Company s procedures with respect to appropriateness of significant accounting policies and adequacy of financial controls.

(c) Discuss with management policies with respect to risk assessment and risk management, including the process by which the company undertakes risk assessment and management.

(d) Discuss generally with management earnings releases, as well as financial information and earnings guidance provided to analysts and rating agencies. The Audit Committee need not discuss in advance each earnings release or each instance in which the Company may provide earnings guidance.

(e) Develop, monitor and reassess from time to time a Corporate Compliance Program, including a Code of Conduct and Ethics for officers, employees and directors, and make decisions with respect to any requested changes to or waivers of such program and codes for directors or officers.

(1) In connection with such Corporate Compliance Program, establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters, and the confidential, anonymous submission by employees of concerns regarding accounting or auditing matters.

(f) Obtain and review from the Company s Chief Executive Officer, Chief Financial Officer and members of its Disclosure Committee at least quarterly a formal written statement disclosing.

(1) all significant deficiencies in the design or operation of internal controls which could adversely affect the Company s ability to record, process, summarize and report financial data and have identified for the Company s auditors any material weakness in internal controls; and

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(2) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company s internal controls.

**7. Other.**

The Audit Committee shall:

(a) Review and reassess the adequacy of its charter and the performance of the Audit Committee annually and recommend any proposed changes to the Board of Directors for approval, and publish the charter as required by applicable law.

(b) Regularly report to the Board of Directors on the Audit Committee s activities and make appropriate recommendations.

(c) To maximize free and open communication, meet in separate executive sessions with each of management, internal audit and the independent auditor in the course of carrying out its duties with respect to each of those groups.

The Audit Committee may, in the course of performing its duties, retain outside legal counsel and other advisors at its discretion and at the expense of the Company.

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**PROXY CARD**

**Important Notice Regarding Internet Availability of Proxy Materials for the Annual Meeting:**

The Form 10-K Combo is available at www.investorvote.com.

**THIS PROXY CARD IS FOR REGISTERED STOCKHOLDERS NOT PARTICIPANTS IN THE COMPANY S 401(K) PLANS**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

**2009 ANNUAL MEETING OF STOCKHOLDERS**

**MAY 19, 2009**

The stockholder hereby appoints William S. Ayer and Keith Loveless, or either of them, as proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and to vote, as designated on the reverse side of this ballot, all of the shares of Common Stock of Alaska Air Group, Inc., that the stockholder is entitled to vote at the Annual Meeting of Stockholders to be held at 2 p.m. on Tuesday, May 19, 2008, at the Museum of Flight, 9404 East Marginal Way South, Seattle, Washington, and any adjournment or postponement thereof.

**THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED AS DIRECTED BY THE STOCKHOLDER(S). IF NO SUCH DIRECTORS ARE MADE, THIS PROXY WILL BE VOTED FOR THE ELECTION OF NOMINEES FOR THE BOARD OF DIRECTORS, FOR THE BOARD S PROPOSALS 2 AND 3 TO RATIFY THE APPOINTMENT OF KPMG LLP AS THE COMPANY S INDEPENDENT AUDITOR AND TO SEEK AN ADVISORY VOTE IN REGARDS TO COMPENSATION OF THE COMPANY S NAMED EXECUTIVE OFFICERS; AND AGAINST STOCKHOLDER PROPOSAL 4.**

**PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY USING THE ENCLOSED REPLY ENVELOPE OR BY VOTING OVER THE INTERNET OR BY TELEPHONE.**

Address Changes/Comments: ________________________________________________________________________________
_____________________________________________________________________________________________

(If you noted any Address Changes/Comments above, please mark corresponding box on the reverse side.)

**CONTINUED AND TO BE SIGNED ON REVERSE SIDE.**

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**ALASKA AIR GROUP, INC.**

**C/O COMPUTERSHARE TRUST COMPANY, N.A.**

**P.O. BOX 43101**

**Providence, RI 02940-5067**

## Electronic Voting Instructions

**You can vote by Internet or telephone!**

**Available 24 hours a day, 7 days a week!**

Instead of mailing your proxy, you may choose one of the two voting methods outlined below to vote your proxy.

VALIDATION DETAILS ARE LOCATED BELOW IN THE TITLE BAR.

**Proxies submitted by the Internet or telephone must be received by 11:59 p.m. Eastern Time, on Monday, May 18, 2009.**

**Vote by Internet**

Log on to the Internet and go to **www.investorvote.com/alk**

Follow the steps outlined on the secured website.

**Vote by Telephone**

Call toll free **1-800-652-VOTE (8683)** within the United States, Canada & Puerto Rico any time on a touch tone telephone. There is **NO CHARGE** to you for the call.

Follow the instructions provided by the recorded message.

Using a **black ink** pen, mark your votes with an X

as shown in this example. Please do not write X

outside the designated areas.

## Annual Meeting Proxy Card

**Proposals The Board of Directors recommends a vote FOR all the nominees listed, a vote FOR**

**Proposals 2 and 3, and AGAINST Stockholder Proposal 4.**

| For | Withhold | For All |
|---|---|---|

| | All | All | Except | |
|---|---|---|---|---|
| 1 Election of Nominees for the Board of Directors | | | | To withhold authority to vote for any individual nominee(s), mark For All Except and write the number(s) of the nominee(s) on the line below: |

**Nominees:**

01) William S. Ayer
02) Patricia M. Bedient
03) Phyllis J. Campbell
04) Mark R. Hamilton
05) Jessie J. Knight, Jr.
06) R. Marc Langland
07) Dennis F. Madsen
08) Byron I. Mallott
09) J. Kenneth Thompson

| | For | Against | Abstain |
|---|---|---|---|
| 2 Appointment of KPMG LLP as the Company s Independent Auditor | | | |

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| | For | Against | Abstain |
|---|---|---|---|
| 3 Advisory Vote on the Compensation of the Company s Named Executive Officers | | | |

| | For | Against | Abstain |
|---|---|---|---|
| 4 Stockholder Proposal regarding Special Shareholder Meetings | | | |

## Non-Voting Items

**Change of Address** Please print your new address below:

**Comments** Please print your comments below:

## Authorized Signatures

**This section must be completed for your vote to be counted. Date and Sign Below**

Please sign exactly as name(s) appear hereon. Joint owners should each sign. When signing as attorney, executor, administrator, corporate officer, trustee, guardian, or custodian, please give full title.

Date (mm/dd/yyyy) Please print date below.

/ /

Signature 1 Please keep signature within the box.

Signature 2 Please keep signature within the box.

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**VOTING INSTRUCTION FORM**

This proxy covers all shares for which the undersigned has the right to give voting instructions to Vanguard Fiduciary Trust Company, Trustee of the Alaska Air Group, Inc. Alaskasaver Plan, , the Alaska Airlines, Inc. COPS, MRP and Dispatch 401(k) Plan, and the Horizon Air Industries, Inc. Savings Investment Plan, and/or Fidelity Management Trust Company as Trustee of the Alaska Airlines, Inc. Pilots Investment and Savings Plan. This proxy, when properly executed, will be voted as directed. If voting instructions are not received by the proxy tabulator by 11:59 p.m. Eastern Time on Thursday, May 14, 2009, you will be treated as directing the Plan s Trustee not to vote your shares held in the Plan.

I understand that if I sign but do not indicate a choice on any of the proposals on the reverse side of this card, my shares will be voted on that proposal in accordance with the recommendations of the Board of Directors, which are as follows: FOR the Board s nominees in Proposal 1, FOR Proposals 2 and 3, and AGAINST Stockholder Proposal 4.

| | |
|---|---|
| **ALASKA AIR GROUP, INC.** | **2009 Annual Meeting of Stockholders** |
| **C/O COMPUTERSHARE TRUST COMPANY, N.A.** | **Tuesday, May 19, 2009 - 2 p.m. Pacific Time** |
| **P.O. BOX 43101** | **The Museum of Flight** |
| **Providence, RI 02940-5067** | **9404 E. Marginal Way South** |
| | **Seattle, Washington** |

**Internet and telephone voting will be available 24 hours each day**

**until 11:59 p.m. Eastern Time, Thursday, May 14, 2009.**

**Your vote is important. Please vote immediately.**

| | | |
|---|---|---|
| **Vote-by-Internet** | | **Vote-by-Telephone** |
| | **OR** | |
| **Log on to the Internet and go to** | | **Call toll-free** |
| **www.investorvote.com/alk** | | **1-8800-652-VOTE(1-877-652-8683)** |

**If you vote over the Internet or by telephone, please do not mail your card.**

If you are returning your proxy card by mail, detach the lower portion and return in the enclosed envelope to Alaska Air Group, Inc., c/o Computershare Trust Company, N.A., Proxy Services, P.O. Box 43101, Providence, RI 02940-5067.

When completed and signed, this proxy will be voted as you have directed. If completed and signed with no direction given, it will be voted FOR ALL NOMINEES in Proposal 1, FOR Proposals 2 and 3, and AGAINST Stockholder Proposal 4.

1. Election of Directors

NOMINEES:

(01) William S. Ayer

(02) Patricia M. Bedient

(03) Phyllis J. Campbell

(04) Mark R. Hamilton

(05) Jessie J. Knight, Jr.

(06) R. Marc Langland

(07) Dennis F. Madsen

(08) Byron I. Mallott

(09) J. Kenneth Thompson

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| FOR ALL NOMINEES | WITHHELD FROM ALL NOMINEES |
|---|---|

______________________________________
For all nominees except as noted above

| | FOR | AGAINST | ABSTAIN |
|---|---|---|---|
| 2. Board Proposal to Ratify the Appointment of KPMG LLP as the Company s Independent Auditor | | | |
| 3. Board Proposal Seeking Advisory Vote on the Compensation of the Company s Named Executive Officers | | | |
| 4. Stockholder Proposal on Special Shareholder Meetings | | | |