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INVESTING

## Alaska Air Should Continue to Soar

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May 17, 2013

With Alaska Air Group (ALK) hitting a 52-week and all-time high on March 13 of $59.88, the question remains whether this high-flying regional airline can continue to soar and deliver capital appreciation to shareholders. All signs point to Alaska Air being able to steer its way to earnings growth and healthy profit margins in the quarters ahead.

### Alaska Air May Still Be Significantly Undervalued

Despite putting up spectacular business metrics and strong year-over-year top-line revenue growth of 7.85%, the case can be made that Alaska Air is still a value play. As compared to peer regional airlines, the company still appears to trade at a healthy or even a steep discount.

According to Capital IQ, Alaska Air had a trailing P/E of 13.53 (ttm), with an operating margin of 12.63% (ttm), and a ROE of 24.35% (ttm) as of market close on Mar. 14. In comparison, JetBlue Airways (JBLU), another leading regional and a darling of the New York media, posted a trailing P/E of 17.20, an operating margin of 7.19%, and an ROE of just 7.02% for the same time period. Southwest Airlines (LUV), the gold standard of the industry, boasts even richer valuations than JetBlue, with a trailing P/E of 22.41, an operating margin of 4.72%, and a ROE of 6.07%.

### Alaska Air Continues to Demonstrate Operating Discipline

In the company's February operational update, published to PR Newswire on March 4, Alaska Air reported "a 6% increase in traffic on a 4.8% increase in capacity compared with February 2012." These statistics included Alaska Air and those airlines under capacity purchase agreements, including Horizon, SkyWest, and Pen Air.

Alaska Air also had a record 90.6% of its flights arriving on time in February, inching up from 89.5% from February 2012. In addition, on February 19, FlightStats.com named Alaska Airlines "the No. 1 on-time major carrier in North America for the third year in a row." Alaska Air Group's average on-time rate for 2012 was 87.26%, as compared to 79.62% for all other North American carriers.

**A Management Team that Understands How to Incentivize**

In the airline industry, financial and operating outperformance is most often spurred by a healthy working relationship between a management team and union employees. And a happy work environment typically goes together with providing adequate compensation to the rank and file. The recent troubles and reorganization experienced in the fall of 2012 at American Airlines with its union pilots and cancelled and delayed flights speaks volumes to this issue. Alaska Air's innovative "Performance Based Pay Plan" seems to satisfy all involved parties.

The Alaska Air plan, with a target annual bonus of 5% of annual salary, compensates union employees for meeting specific company-wide goals for safety, customer satisfaction, cost control, and maintaining profit margins. According to a company press release from Feb. 27, Alaska Air paid "bonuses totaling nearly a month's pay…to nearly 13,000 employees for exceeding the company's 2012 operational and financial goals." The nearly 8% bonus for fiscal 2012 performance was provided "in addition to the $1,100 in bonuses, on average, that each employee earned…for achieving monthly on-time and customer satisfaction targets."

With an undervalued business, continued operating discipline, and an adequate incentive plan for its union employees, Alaska Air has positioned itself, despite hitting all-time highs, to provide further price appreciation through fiscal 2013.