Alaska Airlines Valuation

Corporation Finance

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Agenda

- Alaska Airlines Overview
- Valuation Analysis
- Modigliani-Miller Assumptions
- Impact of AI

Alaska Airlines Overview

History

- Based in Seattle
- Began as McGee Airways with two aircraft transporting passengers, cargo (often liquor), and mail.
- Is now the 5th largest U.S. airline by passengers carried; 49M passengers in 2024 with 326 aircraft in operation.
- Listed on NYSE under ticker ALK since 1985; part of S&P 400 (mid-cap).

2023 — **Merged with Hawaiian Airlines.**

2020 — **Joined OneWorld Alliance.**

2016 — **Acquired Virgin American.**

1987 — Acquired Jet America Airlines.

1986 — Acquired Horizon Air.

1985 — Formed Alaska Air Group as holding company.

1944 — Renamed Alaska Airlines.

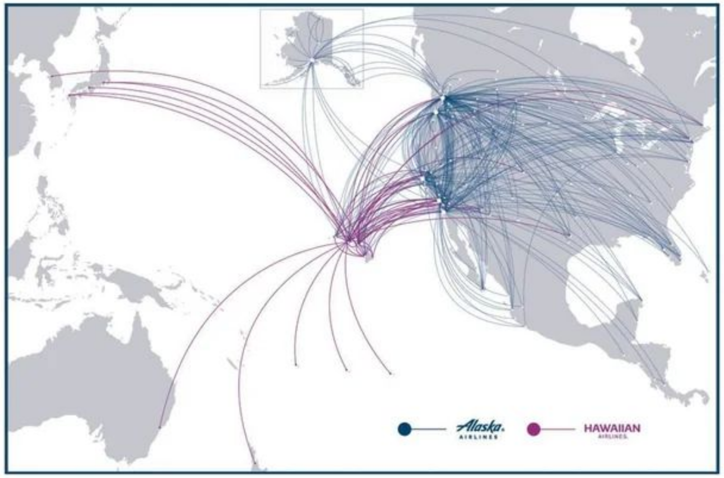
1934 — Merged with Star Air Service.

1932 — Founded as McGee Airways.

Operations

- Ran a streamlined operating model with a single-model fleet: Boeing 737.
- Hawaiian added 50+ Airbus planes.
- Extensive U.S. West Coast service gained access to East Asia and Pacific destinations.

Combined Route Network



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Valuation Assumptions & Methodology

Assumptions

- **β_E = 1.4**[1]
- **FCF** based on a 5-year lookback period to match β_E
- **Corporate tax rate**: 21%.
- **Risk-free rate:** 5%[2]
- **Market risk premium** (Average Market return[3] - Risk-free rate): 5%
- **β_D: 0.135**
  - Bond rating proxy[4]
  - BB+ increases value, likely due to increased lease from merger, but reflecting other similar airlines places it lower (Delta, Southwest at BBB)

[1] Sourced from Yahoo Finance. 5-year monthly retrospective equity beta.
[2] Bloomberg
[3] NerdWallet
[4] Page 413. Berk and DeMarzo - Corporate Finance (3rd Ed)

Methodology

- **WACC Method because:**
  - From 31 Dec 2024 - 31 March 2025, D/C ratio remained constant at 58%, even though not rigidly followed
  - Generally stable
- **No need for twin method to calculate β_E because:**
  - WACC does not require twin. ALK is publicly traded for 40 years. Maintained similar operations (hence assets have not changed significantly) throughout, M&As around commercial airlines business

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Valuation Analysis: Forecasting Future Cash Flows

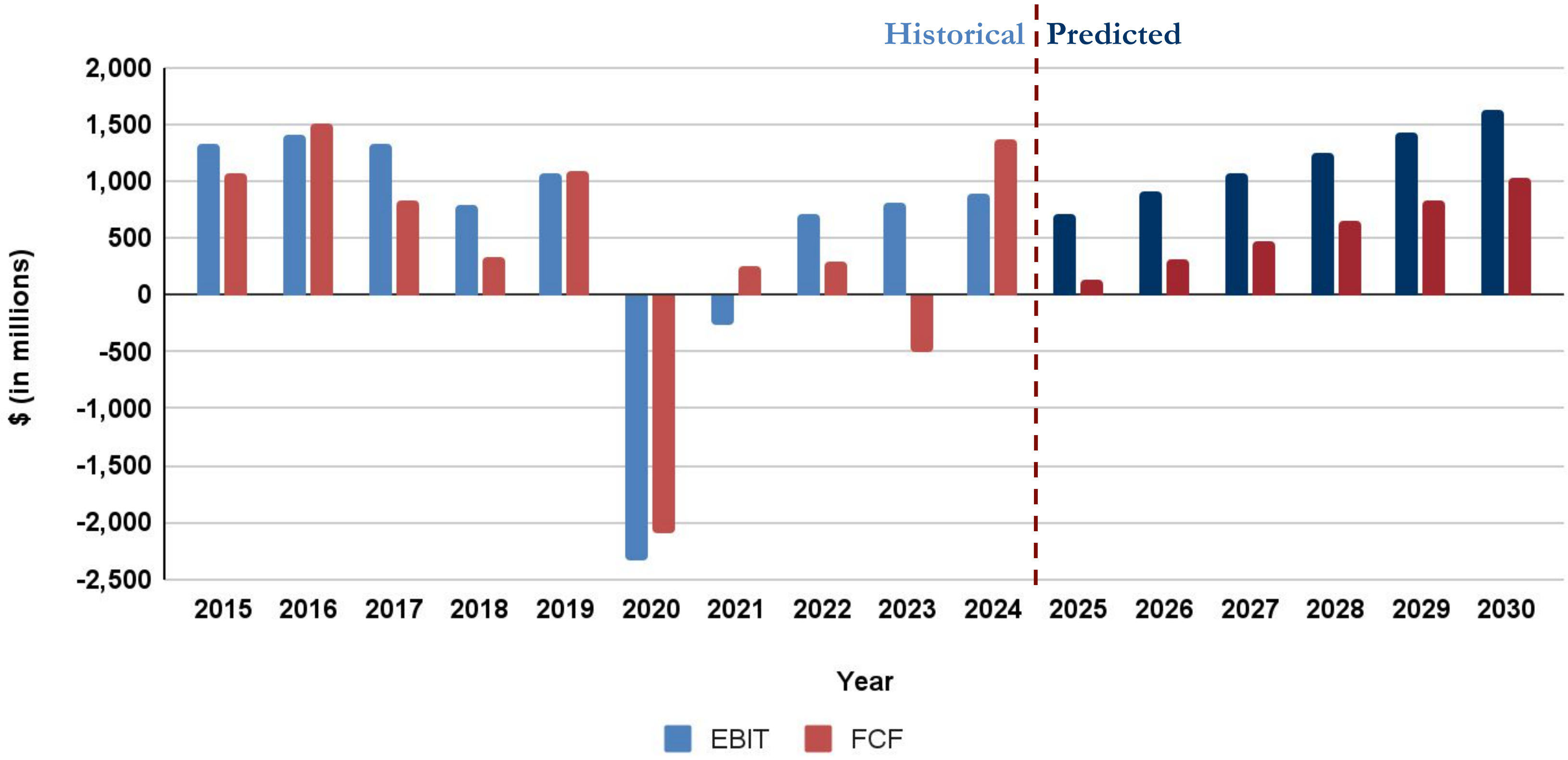
$FCF^{1} = EBIT(1-t_c) + \text{Depreciation} + \text{Stock-based Comp} - CAPEX - \Delta NWC$

EBIAT	• *Negative growth rate* in Y1 aligned with Alaska's own projections due to merger integration activities • *Large positive growth rate* in Y2 showing that merger benefits, though smaller than Virgin's, will compensate • *Rolling average linear* growth + inflation after Y2 in line with pre-pandemic stable periods
Depreciation	• High rate at 25% in Y1 given acquisition of Hawaiian's planes, then steadily increasing at 7% (average of the past 10 years)
Stock-Based Comp	• High growth at 30% in Y1 driven by acquisition of Hawaiian employees, then trails off to 10% growth rate (rate of hiring with SBC)
CAPEX	• Assumed $1.4B + inflation each year due to acquisition of new planes
ΔNWC	• Assumed 10-year average, no growth
Discount Rate (r_{WACC})	• Derived from the average r_{WACC} across 2020-2024, which was calculated based on assumptions and annual historical debt and equity ratios

Source: Alaska Airlines Investor Relations Stock information

[1] FCF = Free Cash Flows

EBIT and FCF Historical & Predicted



Valuation Analysis: Conclusion

Share Price = (Enterprise Value - Net Debt) / Shares Outstanding

where **Enterprise Value - Net Debt = Market Value of Equity**

	Current Value	Our Estimate	% difference
Enterprise Value	$10.170B	$13.526B	+33%
Market Value of Equity	$6.359B	$9.714B	+53%
Share Price	$52.38	$80.02	

Net Debt = $3.8B (book value, 2024)
Shares Outstanding = 121.39M[1]

Conclusion: Buy

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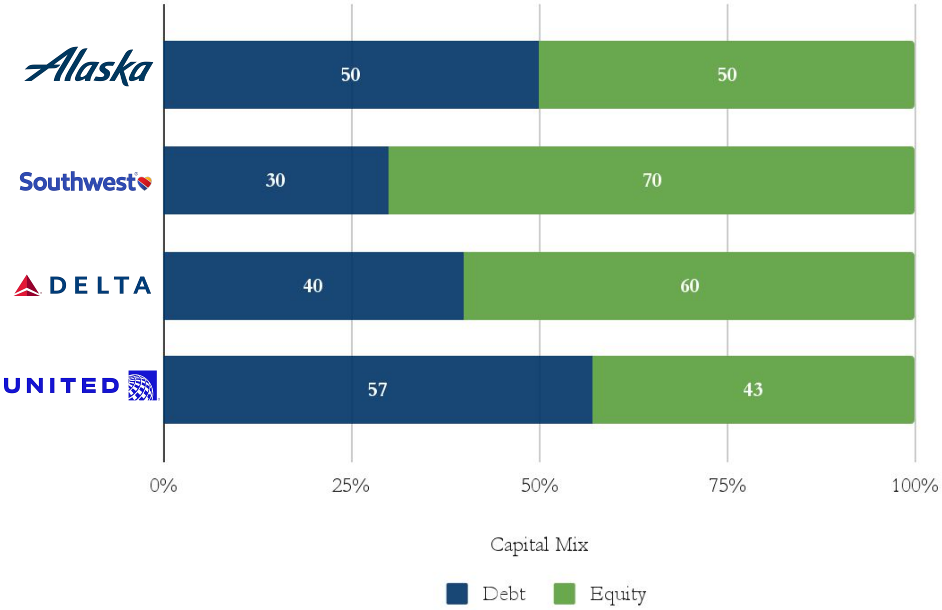
[1] Sourced from Yahoo Finance.

Capital Structure Analysis

Current Capital Structure

- 50%/50% Debt and Equity
- $4.8B in debt (4.7% avg. interest rate) and $1.2B in leases
- Utilize both tangible (planes) and intangible (loyalty program, landing slots) to collateralize debt

Peer Comparison



Capital Structure Analysis

Hawaiian Acquisition

- 100% cash transaction - $1B cash + $900M debt assumed
- Refinanced Hawaiian debt using loyalty program as collateral eliminating high yield (11%) HA debt assumed at SOFR + 1-1.625%

Recommendations

- Maintain moderate levels of debt
- Airline cash flows can be unpredictable due to fluctuations in fuel prices and macroeconomic conditions
- History of bankruptcies in industry
- Take advantage of debt tax shields, of less value with lower corp tax rate and deduction limitations under the 2018 TCJA.

Valuation vs. Share Price

Undervaluation Support

- The Hawaiian merger unlocks many long-haul international routes to East Asia, a growing travel market with higher margins and lower marginal cost than domestic service.
- Major synergies from the merger with Hawaiian such as synchronizing the pilot and flight attendant contracts are not fully realized as of May 2025.
- Alaska now has enough capacity to offer meaningful route networks, flexibility, and loyalty programs to compete with the big 4 domestic airlines.
- ALK has authorized $1B for the repurchase of shares over the next 4 years, signaling confidence. Upon the announcement, their share price rose from ~$54 to $64.
- Alaska assumed and refinanced $900M of Hawaiian's debt during the merger.
- As recently as February, the market valued their stock in the high $70s.

Overvaluation Support

- Alaskan Airlines posted net earnings losses of $166 in Q1 2025[2], potentially signaling that integration with Hawaiian Airlines has presented ongoing operational challenges and is incurring large costs
- All airlines are highly exposed to the fuel market and may be destabilized by fluctuations in fuel prices.
- Alaskan Airlines has utilized conservative estimates when valuing its mileage program[1]
- Alaskan started partnering with Amazon in Q4 2023 to start a freight service which could spread Alaskan operations too thin

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[1] Alaskan Airlines 2024 Annual Report
[2] Alaska Air Group Q1 2025 Earnings Results

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Modigliani-Miller Assumptions

Assumption	Violated?	Reason
Perfect & complete capital markets	Yes	Large acquisition premium, investor frictions, and opaque loyalty valuation.
No taxes	Yes	Debt used for financing creates tax advantages via interest deductibility.
No financial distress costs	Yes	Reported losses, labor misalignment, and regulatory conditions impose indirect costs.
Capital Structure Does Not Affect Cash Flows or Investments	Yes	Cash + debt reduce flexibility for post-merger investment and expansion.
Symmetric information	Yes (Critical)	Financing signals insider confidence; key value drivers not visible to the market.

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AI Disclaimer

Uses	Pros	Cons
Search	Find relevant information from financial statements	Unreliable Sources - Social media platforms, broken source links
Research	Get familiar with company faster	
	Sense check for any qualitative reasonings	

Appendix

Data Sources

- We sourced financial information about ALK from Capital IQ who produces "Unlevered Free Cash Flow" and "Levered Free Cash Flow" and line items which represent all cash flows available to both equity and debt holders and cash flow available to equity holders after debt obligations are met, respectively.

Source: Alaska Airlines Investor Relations Stock information

Signals of mispricing: December 2024 Repurchase

- At its Investor Day on December 10th, 2024, ALK announced its plan to use $1B for the repurchase of shares over the next 4 years.
- That day, they immediately started buying back shares worth $250M at $64.23, almost 19% higher than the pre-announcement price. After the announcement, the share price leveled off at $64.09, or 99.7% of the offer price.

Figure 1. ALK pre-announcement price, Dec 9, 2024

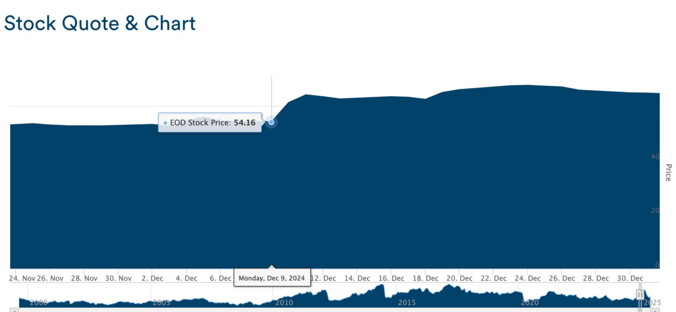
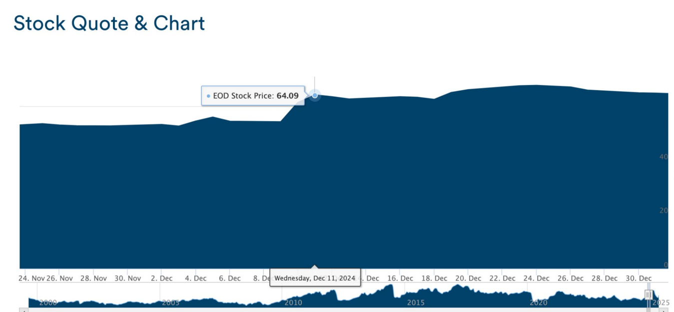


Figure 2. ALK post-announcement price, Dec 11, 2024



- ALK's continued buyback strategy signals confidence in the value of their shares

Valuation Analysis: Forecasting Future Cash Flows

FCF[1] = EBIT(1-t_c)+ Dep + Stock-based Comp - CAPEX - ΔNWC

- **EBIAT:** Negative growth rate in Y1 aligned with Alaska's own projections due to merger integration activities, large positive growth rates in Y2 and Y3 showing that merger benefits will start to compensate, average linear growth + inflation after Y3 in line with pre-pandemic norms
  - Pre-pandemic: Excluding Virgin merger year 2017, ALK's pre-pandemic revenues were growing at an average of **5.8%**.
  - Fuel, pandemic, mergers all affect EBIT
  - General airline growth: 4.4% next 5 years[2]. We predict ALK, as a fifth growing player, will grow faster than the airline market in coming years.
- **Depreciation:** High rate in Y1 given acquisition of Hawaiian's planes, then steadily increasing at the average of the past 10 years
- **Stock-based Compensation:** High growth at 30% in Y1 driven by acquisition of Hawaiian employees, then trails off to 10% growth rate (rate of hiring with SBC). Non-cash line item.
- **CAPEX:** Assumed $1.4B + inflation each year due to acquisition of new planes
- **ΔNWC:**
- **r_{WACC}:** Derived from the average r_{WACC} across 2020-2024, which was calculated based on assumptions and annual historical debt and equity ratios.

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Source: Alaska Airlines Investor Relations Stock information
[1] FCF = Free Cash Flows
[2] Based on Statista Market Insight