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AAL - Q3 2019 American Airlines Group Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 revenue of $11.9b and net profit, excluding net special items, of $630m or $1.42 per diluted share. Expects FY19 diluted EPS, excluding net special items, to be $4.50-5.50.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Third Quarter 2019 American Airlines Group Inc. Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions).

I would now like to hand the conference over to your speaker today, Mr. Dan Cravens. Sir, you may begin.

Daniel Cravens - *American Airlines Group Inc. - MD of IR*

Thank you, and good morning, everyone, and welcome to the American Airlines Group Third Quarter 2019 Earnings Conference Call.

With us in the room this morning is Doug Parker, Chairman and CEO; Robert Isom, President; and Derek Kerr, our Chief Financial Officer. Also in the room for our question-and-answer session are several of our seniors execs, including Maya Leibman, our Chief Information Officer; Steve Johnson, our EVP of Corporate Affairs; Elise Eberwein, our EVP of People and Communications; Don Casey, our Senior Vice President of Revenue Management; as well as Vasu Raja, our Senior Vice President of Network Strategy.

Like we normally do, Doug will start the call with an overview of our financial results. Robert will then follow with commentary on operational performance and our commercial activities for 2019 and 2020. Derek will then walk us through the details on the third quarter and provide us some additional information on our guidance for the remainder of the year and some preliminary guidance for 2020. And then after we hear from those comments, we'll open the call for analyst questions and, lastly, questions from the media. (Operator Instructions)

Before we begin, we must state that today's call does contain forward-looking statements, including statements concerning future revenues and costs, forecast of capacity traffic, load factor, fleet plans and fuel prices. These statements represent our predictions and expectations as to future events, but numerous risks and uncertainties could cause actual results to differ from those projected. Information about some of these risks and uncertainties can be found in our earnings press release issued this morning and our Form 10-Q for the quarter ended September 30, 2019.

In addition, we will be discussing certain non-GAAP financial measures this morning, such as pretax profit and CASM, excluding unusual items. A reconciliation of those numbers to the GAAP financial measures is included in the earnings release and that can be found in the Investor Relations section of our website.

A webcast of this call will also be archived on the website. The information that we're giving you on the call is as of today's date, and we undertake no obligation to update the information subsequently.

So thanks again for joining us this morning. At this point, I'll turn the call over to our Chairman and CEO, Doug Parker.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Thanks, Dan. Good morning, everybody. Thanks for joining us. Today we announced pretax earnings, excluding special items of $835 million or $1.42 per share. That's a 60% increase in year-over-year pretax earnings and a 20% increase in EPS. But we know these earnings and the increase in earnings should have been even better.

Our third quarter results reflect 2 major challenges that impacted our business. First, the 737 MAX fleet remaining grounded throughout the quarter for us, negatively impacting our pretax earnings by an estimated $140 million in this quarter alone. Second, we had significant operational challenges at American in the first half of the quarter as we continue to work on negotiating an industry-leading contract we want for our TWU and IAM team members.

As it relates to the 737 MAX, that situation is of course ongoing. We have 2 goals for the MAX. First, of course, is for Boeing to complete the FAA's required recertification process and ensure the aircraft is safely flying again. The second is to ensure that American is compensated for the loss revenue that the MAX grounding has caused, the missed deadlines and extended grounding for our customers, our team members and our shareholders. So we're working to ensure that Boeing's shareholders bear the cost of Boeing's failures, not American Airlines' shareholders.

Turning now to our second main challenge, the TWU/IAM contract. We've seen significant improvements in our operational reliability as our negotiations have resumed. We've been in mediated talks through the National Mediation Board since early September. Those are our first talks since April, and both parties have agreed not to discuss the content of those talks publicly at the request of NMB. But you should know that we're very focused on reaching an agreement which is fair to all involved and ensures our operation is back on track.

Now we recognize that beyond these 2 factors, the status quo is not an option. We're committed to urgently improving performance and enhancing shareholder value. We've long talked about building the trust of our stakeholders and creating value for the long term, but we also appreciate that, in many respects, the long term is now. We know we need to do better, and we will.

As we near the end of 2019, we're committed to deliver on 3 key areas that will create value for our shareholders in 2020: operational excellence; efficient and profitable growth; and significant free cash flow generation. I'll talk a bit about each of those.

First and foremost, we must restore American's operational reliability to the standards of excellence that our customers and our team members deserve. Importantly, we believe the issues that impacted our operations for much of the summer are now behind us. We had an excellent September and that performance has continued into October.

But 2 months don't make a trend, and we won't rely entirely on our recent performance or our forward confidence. As Robert will discuss in more detail, we're executing on specific plans to improve our operating reliability beyond reaching a labor agreement and specific goals that we will meet. We simply will not allow our customers and team members to experience another period like this past summer again.

Second, we're going to grow American's network in 2020 by approximately 5% through efficient and profitable growth. We anticipate much of this growth will be added at or above system average unit revenues because it's driven by gates we've been able to acquire in Dallas/Fort Worth and Charlotte. These are 2 of our highest margin hubs. And as we've already experienced in DFW this year, routes that are added into these large connecting hub operations immediately produce unit revenues in excess of our systemwide average. And it will be efficient growth. For example, many of the costs of our 737 MAX aircraft are already in our cost structure. Our operational reliability improvements will also drive some of the growth, and these improvements increase flying and reduce cost. Combining those factors with our previously announced cost initiatives give us confidence that our above-average RASM growth will be added at below-average incremental unit cost. Derek will provide some high-level CASM estimates in his remarks and will provide more specific details on the fourth quarter call once we complete our budgeting process. But just know, we're excited about our prospects to grow and to grow efficiently and profitably in 2020.

Lastly and importantly, we are confident we will begin to produce significant free cash flow for our investors in 2020 and beyond. Much of that confidence is driven by the earnings improvement we expect from the first 2 I've just discussed, and we expect those initiatives to improve profitability over where it would be otherwise. At the same time that's happening, we are reaching the end of an unprecedented program to invest capital into American Airlines. The $30 billion in investments we've made over the past 6 years have been necessary to integrate and upgrade 2 airlines that have suffered a lack of investment and most importantly, to modernize an aging fleet. That work is now done, and we anticipate our CapEx requirements will fall from the over $5 billion per year average over the past 6 years to $3.7 billion in 2020, $2.1 billion in 2021 and should average approximately $3 billion thereafter. What that means for our investors is if our estimated 2019 earnings are unchanged in both '20 and '21, and this is not an earnings forecast, just an earnings constant analysis, then our free cash flow would be approximately $2.5 billion in 2020 and $3 billion in 2021. That's $5.5 billion in free cash flow in just 2 years at a company that has a current market capitalization of approximately $12.5 billion or a 44% free cash flow yield over just 2 years. And again, that's on constant 2019 earnings. None of us would be pleased with constant 2019 earnings in 2020 and 2021.

So as we said in the past, as we generate that significant free cash flow, we will naturally delever our balance sheet. We'll repay debt as it comes due, and the need to raise new debt to finance new aircraft will now be much lower. We anticipate that decline in adjusted debt will be significant. We expect adjusted net debt will fall by approximately $3 billion to $4 billion in the next 2 years and by $8 billion to $10 billion over the next 5 years.

And we will, of course, continue to return cash in excess of our needs to our shareholders. Entering a period of significant free cash flow generation will facilitate that initiative.

So in summary, we're pleased the 2 large issues that have impacted our performance should be addressed as we enter 2020, but we are not of the view that correcting those 2 items alone are sufficient for our customers, our team members or our shareholders. As it relates to our shareholders, for example, we know we have a profitability margin gap versus our large competitor, and we're committed to narrow that gap in 2020 and beyond. We're excited about our prospects for the future and are grateful to the 130,000 hardworking team members of American Airlines and the amazingly great work they do every day to take care of our customers.

With that, I'll turn it over to Robert Isom.

Robert D. Isom - *American Airlines Group Inc. - President*

Thanks, Doug, and good morning, everyone. Before I begin, I'll add my thanks to our team members for doing a great job of taking care of millions of customers during the busy summer travel period. Their hard work was instrumental in our ability to generate record revenue in the third quarter and grow margins, despite the challenges that Doug highlighted. Importantly, we continue to execute on a number of initiatives to improve the trajectory of our business going forward.

As we look at our business, the economy is strong, and the demand for our product remains robust. And we look forward to a strong holiday season. We reported another quarterly record with third quarter revenue of $11.9 billion, 3% higher than the third quarter of 2018. This also marks the 12th consecutive quarter of unit revenue growth, and we expect to produce our 13th next quarter. Derek will talk more about the revenue environment in his remarks.

Global sales and distribution continue to win in the marketplace. During the quarter, corporate revenue growth outpaced system revenue growth on healthy corporate demand, a great result given our operational challenges.

As we look at our operations, we have already seen a significant improvement in our operating reliability. Since June, we have seen consistent month-over-month improvement. And for the full third quarter, our on-time metrics improved at both our mainline and regional operations. In fact, our September on-time arrival performance or A14 was the seventh best month in American's history and our best A14 performance since November of 2017. As Doug mentioned, this improvement continues into October.

We continue to strengthen our operations with ongoing enhancements, including retiring older aircraft, simplifying our fleet and schedule and fortifying our maintenance and airport resources. Our underlying execution is solid, and we are committed to returning American to a position of operational excellence. And as a result, we expect our 2020 completion factor to increase by 1 to 2 percentage points and a significant improvement in all reliability metrics, including on-time performance, baggage handling and customer satisfaction.

We know we can't allow customers and our team members to experience another period like this past summer ever again. So if for some unforeseen events in 2020 lead us to question our ability to meet our reliability standards, we will reduce our schedule rather than let our operations become the buffer. We don't believe that will be required, of course, but we also know it's a commitment we need to make to ensure that we restore operational excellence.

Now with respect to the MAX, we have extended the -- our cancellations through January 15. We continue to work closely with the FAA and Boeing and have built flexibility into that date. Regardless of when the aircraft is recertified, we plan to be prudent as we reintroduce the MAX back into our network. Before it begins commercial service, we will continue our collaboration with the APA and APFA, accomplish training and conduct multiple flights with our pilots, flight crews, executives and other team members to make sure that we are all comfortable that the aircraft is ready for our customers. And only then will we gradually place the aircraft back into our schedule.

As part of our phased approach to reintroducing the 24 MAX aircraft that we have in storage today, we'll begin with 5 aircraft flying in the first 2 weeks. That's 20 departures per day. Two weeks later, we'll add 12 more aircraft. The remaining 7 will be phased into service 2 weeks after that. And we'll add additional MAX aircraft as they become available. And note, by year-end 2020, we had planned to take delivery of an additional 26 MAX aircraft for a total of 50 in our fleet. While 10 of those 26 aircraft have been built, we don't know exactly when they'll be delivered or when the remainder will be built.

Restoration of operating reliability will drive customer satisfaction, but there's much, much more that we're doing to make the journey more efficient, easier and more enjoyable for our customers. In fact, here are several enhancements that launched in the third quarter which demonstrate a steady and consistent focus on improving the customer experience. First off, we put -- we've added rich digital content, which has helped drive a 25% year-on-year improvement in premium economy ticket sales on aa.com. We've created unique opportunities for our customers to upsell into the premium cabin, thereby significantly growing its ancillary revenue. An improved system that makes it easier for families to secure seats together has been added. And we've recently launched the board now notification to reduce the wait time at gates for customers. And we're speeding customers to boarding through biometric boarding at DFW for international departures.

And when there are disruptions, we've added the ability for customers to change flights or receive compensation before traveling to the airport. And we've automated hotel, meal and transportation vouchers delivered electronically to customers during disruptions. The steady stream of customer-focused deliveries provide a better experience for our customers, for our team members and certainly better results for our shareholders. We have a pipeline of additional customer-friendly features that we expect to launch in 2020.

The foundation of customer preference begins with our network. We continue to be extremely excited after seeing the results from our network expansion plans, with growth targeted at our most profitable hubs. This effort began in May where we added 100 daily departures out of our DFW hub. With nearly 2 full quarters under our belt, the results have exceeded our initial expectations.

During the third quarter, we grew domestic capacity at DFW by 9% and produced PRASM growth at the hub of 3.5%. This is the largest capacity expansion at any company in the United States in more than a decade and sets the stage for additional planned expansion next year in Charlotte and at Reagan National in 2021.

On partnership side, late in the quarter, LATAM notified us of their intention to leave the oneworld alliance to form a relationship with Delta. While that's disappointing, but not surprising given the regulatory challenge our proposed joint venture faced, our vast South American network will ensure that we recapture the majority of the potential codeshare revenue on our own aircraft. And that's already proving to be the case. There has been no revenue impact since the announcement. American remains the largest U.S. carrier to Latin and South America, and we're committed to providing the best service to the region for our customers. Recently, we announced additional frequencies between Miami and Lima, São Paulo and Santiago. And we're confident that with the strength of our network, we'll attract other partners to -- in the region.

In the Pacific, we're moving quickly to realize the opportunities provided by our new joint business agreement with Qantas. It was approved by the DOT in July. This agreement allows for commercial integration between American and Qantas, delivering new routes and ultimately, significant customer benefits, including more seamless integration when traveling on the American and Qantas networks.

So in conclusion, we have a great foundation built, and our core business is strong. We made investments to improve the product. Our fleet renewal is -- program is nearing completion, and we continue to refine our network to add margin accretive growth. We're confident that we'll deliver improved results in 2020 and beyond to benefit our shareholders, our customers and team members.

And with that, I'll turn it over to Derek.

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Thanks, Robert, and good morning, everyone. During the quarter, we were able to grow our both pretax margin and earnings per share for the second successive quarter. Our third quarter results came in towards the high end of the guidance range we provided in July.

For the third quarter, our pretax profit, excluding net special items, was $835 million, resulting in a pretax margin, excluding special items, of 7% compared to 6.2% in 2018. Our third quarter 2019 net profit, excluding net special items, was $630 million, a 15% increase over the third quarter of 2018. And our diluted earnings per share, excluding net special items in the third quarter, was $1.42 per share, up 20% or -- from $1.19 per diluted share in the third quarter of 2018.

As Robert mentioned, the revenue environment remains strong, with third quarter top line growth of 3%. Passenger revenues grew by 4.1% to $11 billion, a record for the third quarter. Latin was the best-performing entity during the third quarter, with year-over-year unit revenue improvement of 5.9%. Brazil and Mexico led the way with double-digit improvements in yield, while we improve load factor in the entity overall by 6.5 points.

Pacific unit revenue also continues to show improvement aided by our China restructuring last year, with unit revenue up 1.6%. Specifically, Japan and Australia were up year-over-year, while we face challenges in Hong Kong and Korea.

Atlantic unit revenue declined by 4.6%. This decline was driven by transfer payments related to our joint business agreement of about 2.3 points and currency effect of about 1 point.

International point-of-sale remains challenging, but we successfully shifted the North American point-of-sale and grew load factor by 3.2 points.

Domestically, we saw and continue to see broad-based strength with unit revenue growth of 4% and improved unit revenue across every hub. We continue to see weakness in our cargo business. Weaker demand due to trade concerns across the system drove cargo yields lower by 4% for the quarter. When combined with year-over-year international schedule reductions, the result was cargo revenues fell 19.9% to $208 million.

Total operating expense in the third quarter were up 2.1% at $11.1 billion. When fuel and special items were excluded, our unit cost increased in the third quarter by 4.8% compared to 2018 due primarily to higher salaries and benefits, maintenance and regional expense and lower-than-planned capacity.

Turning to the balance sheet. We ended the quarter with approximately $8 billion in total available liquidity, well above our target liquidity balance of $7 billion. During the third quarter, we paid dividends of $44 million and repurchased $200 million of stock or 7.3 million shares.

As Doug talked about, we have begun to delever the balance sheet as our CapEx requirements have reduced this year.

We expect our adjusted debt position, including pensions, to decrease by $1.5 billion this year.

On October 10, we announced we had removed the 737 MAX from our schedules through January 15, 2020. We now expect the 737 MAX grounding will have a negative full year 2019 pretax income impact of approximately $540 million based primarily on lost revenue from schedule reductions.

Now that we have removed the MAX from 2019, we expect capacity growth of approximately 2.7% for the fourth quarter and 1% for the full year. This is less than half the full year capacity growth we had expected at the start of 2019. Despite this capacity level, our expectations for full year cost per ASM, excluding fuel and special items, is unchanged from previous guidance at approximately up 4%.

For the fourth quarter, we continue to expect that our CASM, excluding fuel and special items, will grow by approximately 3%, despite the additional reduction in ASMs due to the MAX grounding in the fourth quarter.

Looking forward, we see no signs of macro softness in our forward bookings. We expect domestic demand to remain robust and Latin to again be the best-performing international entity. We expect our fourth quarter year-over-year TRASM to be flat to up 2% and PRASM to be about 1 point better than TRASM. We also expect that our pretax margin, excluding net special items, to be between 5% and 7%, the midpoint of which would represent the third consecutive quarter of pretax margin expansion.

Given our expectations for the fourth quarter, we believe that our full year earnings per diluted share, excluding net special items, will be between $4.50 and $5.50. We have tightened the top end of our previous guidance of $4.50 to $6 per share due to the additional $140 million reduction in earnings from the deferral of the MAX in 2020.

Our total projected capital expenditures for 2019 is expected to be $4.3 billion, comprised of $1.7 billion in non-aircraft CapEx and $2.7 billion in aircraft CapEx. The slight change from previous guidance is due to the timing of the MAX deliveries moving from 2019 to 2020.

Finally, I would like to give some preliminary guidance for 2020. We're still working on the final budget, and there is still a measure of uncertainty over when our MAX aircraft will be introduced to service and new aircraft delivered and available for use in our fleet. As Doug mentioned, we plan to grow our network with efficient and profitable growth. At this point, we anticipate total 2020 year-over-year capacity growth of approximately 5%. It is higher than the year-over-year 2020 growth we had anticipated at the beginning of 2019, but is entirely due to the grounding of the MAX and the cancellations resulting from the disruption of our operations, which reduced capacity in 2019. Importantly, our year-end 2020 absolute capacity is in line with our expectations from the beginning of 2019. Given this capacity guidance, we have tightened our estimate for CASM, ex fuel, special items and new labor agreements, to be approximately flat in 2020.

With that, we'd like to turn the call back over to the operator and to begin the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Joseph DeNardi from Stifel.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

I'm wondering if you could just talk about kind of expectations for earnings next year. If you've lost $500 million or $600 million from the MAX and maybe a couple hundred million more from the mechanics issues, how much of that can you kind of recapture next year? Why shouldn't kind of the base level of earnings for the business be somewhere closer to $4 billion next year?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Sure, Joe. I mean again, we will be able to give you much better guidance as we -- our budgeting process has just begun, so we can do a better job of giving you estimates next quarter. But the 2 headwinds that you mentioned that we faced this year certainly should not be headwinds next year in the amounts you described. The one issue I would just pull a little bit down is the MAX. Again, they don't -- they're not all back in January 1, as Robert described, they phase in over the course of the year. So to the extent whatever that headwind was in 2019, I don't think you should build all that in for 2020. But on a run rate earnings, you're right. And again, I'm not by any means trying to give you an earnings estimate, but absolutely agree that whatever earnings are going to be in 2019, they're going to be a good bit better, they're going to be better for the 2 reasons you suggested.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Okay. And then you've never really talked about the free cash flow outlook that bullishly, I don't think, in terms of how much it is relative to your market cap. I just want to make sure I kind of understand. I mean from a leverage standpoint, nothing has changed. The leverage will kind of come down naturally, but we should assume that the free cash flow is primarily used to repurchase stock. Is that the idea going forward?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Yes. Again, let me expand a little bit then. You're right, we haven't disclosed the numbers, Joe, really, I mean not because they're dramatically different than we would have said in the past, they're just now here. We've consistently said in the past that we're going through a period of high CapEx. Once we get through it, you should expect to see us generate free cash flow. And when we do that, you'll see us naturally delever. All of those statements, I -- hopefully you would agree we've always said. What we haven't been able to do or haven't wanted to do really is tell you that 3 years from now, here's what those numbers will be. And now as it's just upon us and as that free cash flow gets generated in 2020, we can give you more clarity on that, so we're happy to. The $5.5 billion of free cash that I mentioned again is simple math on steady state earnings. We can all decide what earnings might be as we go forward, but that's what that is. And again, we certainly aren't going to be happy if 2019 earnings are the earnings in 2021.

The debt paydown numbers that I gave you are reasonably simple math. Just looking at what we know amortizes over the 2 years and what we believe we need to add, as we do have additional requirements, but obviously, the amortizations exceed the requirements. So that's -- that number, again, is nothing -- it is a number we feel comfortable giving because it's what the math is telling us.

And then to your point, to the extent that first number, the free cash flow generation is greater than our needs to run the airline and retire debt, we believe that cash certainly in excess of our very high cash balances is best used by returning it to our shareholders. It's their cash. Us holding more than we need is a horrible use of capital, and we should return that to you as efficiently as possible. When we believe in stocks and their value, we should do that by repurchasing our shares. So that's what you should expect to see from us.

Operator

Our next question comes from Brandon Oglenski from Barclays.

Brandon Robert Oglenski - *Barclays Bank PLC, Research Division - VP & Senior Equity Analyst*

Doug, I guess just looking back on the last couple years, I mean I understand that the MAX definitely was quite disruptive this year. And you guys do have some good things going on in the network. But even giving credit for that, it does look like your op income is still down on like a 2-year basis in what's been a pretty robust economy. And not that we're necessarily comping every day to your peers, but their op income is up in that same time period. So what -- retrospectively looking forward, what can change in this dynamic where American can start to really leverage the economy?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Sure. Thanks, Brandon. Again without having those numbers in front of me, what I do know is first off, I would always argue that for airlines, operating income is a tough measure to look at. If you're trying to really look at just the operating performance, I'd encourage you to look at EBITDAR. I know we always encourage you to capitalize our operating leases on the balance sheet. And you should do the same thing by not including the operating leases in your operating cash flows. It makes a difference. So when you do look at -- so all I'd suggest to you, without even looking at the numbers myself is part of what you're seeing in deterioration relative to others is what I just talked about, which is our fleet modernization, which is now done versus theirs, which is about to come. But putting that aside, I don't disagree with your point, and none of us should, that we've underperformed elsewhere, not just in the ownership cost. And look, the -- as we look to that, the primary reason is related to the issues we talked about. We've seen our properly adjusted and stage-leap adjusted unit revenue gap, certainly, versus Delta which was widening as we -- through every year since the -- I'm sorry, which was narrowing every year since the merger, starting to widen in the last 6 quarters. And that's not what it should be doing. We should be narrowing that gap, not widening it. Again there are a number of reasons as to why it is, but the biggest ones tend to be that we haven't executed on our operation. But by the way, there's no doubt the 737 MAX issue certainly has led to the widening of that gap. But look, as opposed to trying to explain what it is, what I'll tell you is we're committed to narrowing it going forward and we feel very good about that, Brandon.

Brandon Robert Oglenski - *Barclays Bank PLC, Research Division - VP & Senior Equity Analyst*

Okay. I appreciate that, Doug. And I mean the relationship still kinds of hold on an EBITDAR basis, but that's understood.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Fair enough.

Brandon Robert Oglenski - *Barclays Bank PLC, Research Division - VP & Senior Equity Analyst*

I guess on the upside, though, you guys did call out, I think Dallas in the second quarter RASM being up 1.5 points. I think now you're talking about, and correct me if I'm wrong, but the hub being up about 3.5 points in the third quarter. So looks like maybe incrementally, as your hub's scaling here, it's getting better performance, is that right? And do we think that Charlotte can be the same in 2020?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Vasu Raja's here. We'll let him take that one, Brandon.

Vasu Raja - *American Airlines Group Inc. - VP of Network Planning*

Yes, and so a little bit of the effect that you see is really the effect of the peak of the summer happening more in the third quarter. That said, we do see a significant benefit. As we improve the connectivity of our hubs, we see that not only the marginal revenues of our new flying is coming in well above the system average, it's having a meaningful impact on all the flights that remain. So for example, the new flights -- the new routes that we added and the new frequencies came in at a 85-plus-percent marginal PRASM, and we were expecting them to come in at 75%. So it has a meaningful impact on our big trunk routes, DFW-LA, DFW-Vegas. We do anticipate an effect like that in Charlotte. And indeed, we expect a meaningful effect in Charlotte because while we grow the hub and departures and improve its connectivity, we'll also upgauge the hubs, so we'll have more seats on all of those really advantaged connections.

Operator

Our next question comes from Jamie Baker from JP Morgan.

Jamie Nathaniel Baker - *JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Nice to hear the renewed vigor. Are there any triggers with Boeing in the contract or potentially with lessors that would allow you to alter the delivery schedule once the MAX pipeline resumes? Also on the 5% capacity growth, what metrics do you look towards next year in determining if that's the right rate? For example, would you tolerate margin contraction in 2020? After all, with the pace of the buyback, you could still see CASM earnings growth and free cash flow, but at lower margins. Would that be deemed acceptable by the team?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Let me try and then others can chime in if I don't have it right. Irrespective what the contract may or may not do, we want these airplanes. I mean we want -- we've bought -- we have -- if we could be flying them all today, we -- that's what we'd be doing. So as soon as they can be -- as soon as they are certified and have got pilots trained, we'd like to get them in service as quickly as possible. What Robert described here is what we believe is as quickly as possible. So that -- and that's what we think the right thing to do is, so we're not looking to change the delivery schedule. Indeed if anything, we'd like to accelerate the delivery schedule. We feel really good about our growth prospects. Second part of the question, I'm sorry, I think I might have answered already, but go ahead. What was it again?

Jamie Nathaniel Baker - *JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Yes, would you tolerate margin contraction next year? After all, and not to devolve into a modeling discussion, but if you still get the earnings growth and free cash at lower margins, would you accept that outcome?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Well, We're not -- anyway, we're going to try and maximize value at all times, not so much try to manage earnings as much as maximizing value. We believe the way to maximize value is to continue to expand our network. We have fewer airplanes today than we would like. That's a rare situation for American Airlines. But I'm telling you, every meeting we have with our planning team, they're looking -- they're on the table asking for more aircraft, not fewer. We want to get those airplanes into the system. Again this is not -- this is a growth you should be happy about that we're pounding the table for. This is in our core markets. Filling out something that is very rarely able -- we're able to do, we just take hubs like Dallas/Fort Worth and Charlotte where we have gates and add more flights into those hubs. That's really, really good growth. And we want to do it as quickly as we can. And irrespective of what that may do to the next year's margins or earnings, I don't know. But I know it's the right decision for our shareholders.

Jamie Nathaniel Baker - *JP Morgan Chase & Co, Research Division - U.S. Airline and Aircraft Leasing Equity Analyst*

Okay. And second question, does the free cash flow commentary for 2020 include or is it predicated on Boeing compensation?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

It is not, though, because again, I told you -- again, what it's predicated on is, to be crystal clear, it's predicated on flat earnings year-over-year. So that's what it is. And again, that's not an earnings forecast. It's just -- it's giving you a free cash flow number. If we have flat earnings, you should do your own earnings forecast. We'll do our best to give you better guidance on that next quarter.

Operator

And our next question comes from Darryl Genovesi from Vertical Research Partners.

Darryl J. John Genovesi - *Vertical Research Partners, LLC - Principal*

Derek, if I just take your $540 million number from the MAX hit that you laid out, I assume -- I mean some of that -- I think some of that would probably reverse in 2020, even if the MAX doesn't come back at all just because it's no longer a surprise that you don't have it. Is that accurate? And can you help us break out sort of the impact of having to sort of manage the schedule on a day-to-day basis the way you did versus the impact of just having less capacity overall? Does that make sense?

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Yes, I think so. And I think I understand the reverse side of it. What we have to remember is, I mean this is really total revenue that we lost on this is about $700 million; if you take the proposal, that's the $540 million. So really, we were lower ASMs by about 1.8%. So we just didn't fly those ASMs, right. We don't get those back. So that revenue doesn't come back. Now the expenses that we had and we spent on there, those are going to be there, so you should not see -- when we put this growth back in, you shouldn't see the CASM go up as much because of the fact that the expenses were already there. So the $540 million is really a number where you take about $700 million of revenue due to the not flying, offset by some cost, that gets you there. And you're right, the costs that are embedded in the airlines today are here already to fly the aircraft when they come. So that should be -- I shouldn't have to add those cost as those planes come back in. And I think that's what you're asking, right?

Darryl J. John Genovesi - *Vertical Research Partners, LLC - Principal*

Actually, I was kind of asking more about the scenario where you sort of don't -- you kind of don't get it back, right. I mean suppose January 15 ends up being way optimistic, I'm just try to get a sense of how much I should expect this flat CASM, ex guide to move around based on the fact that I think there are probably, for instance, I mean you're probably not going to be asking pilots to bid on schedules and getting hit by that to the extent that you did early on in this process. And so I guess I was thinking that there's probably some CASM ex-relief associated with just not kind of having to manage things on a day-to-day like that -- day-to-day basis like that.

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Yes, you're definitely right on that. This is assuming the MAX coming back at the schedule that Robert had talked about. There could be changes to that just depending as we go forward. But this is assuming the MAX schedule that Robert talked about where they phase back in into the early part of the year and the deliveries do come in.

Robert D. Isom - *American Airlines Group Inc. - President*

And Darryl, I'll just add that the pilots are here, the flight attendants are here, the gates are here. So for the most part, we're ready to fly these aircraft. If we were to hear something from Boeing that was just incremental changes, there's not a heck of a lot that you can build in. To the extent that there would be something to say, give us much more visibility long into the future, of course we would make adjustments. But right now, it's really just around the edges that we can cut back.

Darryl J. John Genovesi - *Vertical Research Partners, LLC - Principal*

Okay. And have you slowed your hiring at all, in anticipation that this keeps -- that this continues to linger?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

We slowed our hiring early in the fall here, but then we're hiring back up to meet the schedule needs for early part of '20 -- early part of the first quarter. So we're back making sure that we can fly the schedule that Robert talked about with the aircraft coming back, so that when they come back, we're ready to roll.

Operator

And our next question comes from Hunter Keay from Wolfe Research.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense*

I actually have a question for Derek and a question for Vasu. Derek, can you just help me understand the accounting of how you guys will realize the concession payments from Boeing? Don't care how much it's going to be, just want to know if it's going to impact the P&L, is my main question.

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

We do not have an answer on that yet. It all depends on how we get it back. The accounting is if you get it against the aircraft price, that would just go into reduced aircraft price and wouldn't hit the P&L. If it comes back as lost earnings, it possibly could hit the P&L. So we do not know yet. We're in negotiations with Boeing and have continued to talk with them. And as we continue to go through that, we will update everybody on where it will hit the P&L and if it will hit the P&L and what that number is going to be.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Airlines, Aerospace & Defense*

Okay, great. And then Vasu, the 5% capacity growth, I'm surprised that's so low. It implies only about 3.5% core growth in 2020. Can you help me -- can you peel that back for me a little bit? I mean how is it so low? And maybe you can talk about mix of domestic and international gauge anything like that. I was expecting you guys to show more like 4%, 5% sort of core growth. So is that a conservative number? Any color on that will be great from your perspective.

Vasu Raja - *American Airlines Group Inc. - VP of Network Planning*

Yes, Hunter, first of all, we're still working through our high level of operations for next year. But I'd say the simple way to think of it is that about 1.5 points of it or so is just the bring back of the MAX. The remainder of it is the growth of our core business. And of that remainder, it's pretty evenly split between just a variety of gauge initiatives and actual departure-based growth.

As far as domestic-international split, we're still kind of working through that right now. Of course, we've announced a lot of international routes, so you can probably back solve for some of it. But we anticipate that domestic will moderately outgrow international, but it'll be pretty close. But we're refining it more and should have more in the next quarter.

Operator

And Our next question comes from Duane Pfennigwerth from Evercore.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Derek, sorry if I didn't hear it correctly, but does your flat CASM outlook or preliminary flat CASM outlook include or exclude new labor agreements?

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

It excludes labor agreements.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Okay. And how would you handicap probabilities, and I know you don't want to talk about terms, but timing on mechanics and pilots next year?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Duane, it's Doug on that one. Again as I said in my comments, we have agreed at the NMB's request not to discuss where we are in negotiation, when that starts to do it. I know it's important to you. We'll -- hopefully you understand, we're much more focused on getting the negotiations done and don't want to jeopardize that. So if you don't mind, we'll just tell you that we're happy we're in negotiations, we're happy that the NMB has asked us, both sides, not to talk about it. We think that helps the negotiations rather than hurt them, and we don't want to violate that. When we do have a contract, we will absolutely let you know the answers to those questions.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Totally fair. Sorry for asking.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

No, nothing wrong.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Appreciate the surprise that was kind of dumped on you by the Chilean courts, which catalyzed this change with LATAM. But can talk about how you're going to replace that feed? For example, would you envision a JV across multiple airlines in South America?

Robert D. Isom - *American Airlines Group Inc. - President*

I'll go ahead and start on that. The great news is that our network, by far, the best in the South America. There's a lot that we can do to augment that on our own. And while again, LATAM was disappointing, you also have to realize the nature of what that was and what could be. So for now, customers are choosing to purchase American and to fly American. And as we take a look at what goes forward, of course, that network we have in South America is going to be really attractive to a lot of partners. And so we're busy working and exploring and evaluating the opportunities that are out there right now. So good things to come.

Operator

Our next question comes from Savi Syth from Raymond James.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

Just a question on the international growth here in the Transatlantic. I recognize you had some individual items and FX that was kind of hurting it. What's driving kind of the double-digit increase? And would you expect that to moderate given the unit revenue pressures?

Vasu Raja - *American Airlines Group Inc. - VP of Network Planning*

Yes, this is Vasu. Look, a lot of what's really driving our capacity growth, our growth is just simply the growth of capacity. As Derek mentioned in his opening remarks, in the last year, we did a lot to go and restructure our international network. We cut something in the order of 17 or 18 routes across the system that were really long-term money losers, and we turned them into 22 new routes, much of which was growth in Transatlantic and all of which has come in at a really attractive revenue clip. There have been some issues in 3Q with foreign exchange and things like that, as Derek mentioned, but the marginal profitability of the routes we've added in Transatlantic have been pretty impressive, and indeed, year-to-date our Transatlantic unit revenues on an absolute basis have been higher than they've been at any point since the merger. So we're encouraged by it. It's been really great utilization for our airplanes and altogether margin positive for us.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

And then if I may ask another network type question. Just curious on your view on Chicago. You've made some changes there and one of your competitors is definitely kind of refocused in that hub. And now as they kind of introduce the 550, some of the leadership that you had with some of the, kind of the taking advantage of your larger grade regional aircraft opportunity there, that advantage seems to be eroding as we look forward in the network. Any thoughts on how you [view] kind of the performance in Chicago and your positioning in Chicago?

Robert D. Isom - *American Airlines Group Inc. - President*

Yes, we're actually really excited for our future in Chicago on a number of levels. I think for one, and I've talked about this probably in lot of forums, removing Chicago to Asia for us has been actually a big benefit to the Chicago hub. A lot of that was not just unprofitable flying in and of itself, it was claiming space off of domestic airplanes and things like that, that could have otherwise gone to other customers in the Chicago local market or people connecting from other parts of the business. So that alone has been a big change in Chicago. And also as we look forward, though our principal competitor there is indeed rolling out the new product, the reality is we still will be able to offer more first-class seats to the Chicago customer. We absolutely intend to continue doing that. One of the major things that we're excited for, as we go into next year and work through the MAX situation, is that we'll have a lot more flexibility to do things like bring the A319 in Chicago, which will enable us to kind of up-gauge regional jet markets, to vary our capacity more through day of week and to create a lot of variability in the schedule that ultimately goes and attracts the key business customers in the Chicago and Greater Midwest area that our principal competitor seems to be targeting. So we very much like our chances out there. We very much will continue to do that. And even going forward looking longer run, as we ourselves continue aggressively replace single class, 50-seat RJs with 2-class airplanes, Chicago will be a place where we'll continue to thrive and be able to produce improving results.

Donald B. Casey - *American Airlines, Inc. - SVP of Revenue Management*

Yes, this is Don. I'll just add one more data point framing. We really outperformed in the domestic business in the third quarter. We had [ERV of 4%] and our best performing hub for unit revenue was Chicago.

Operator

Our next question comes from Rajeev Lalwani from Morgan Stanley.

Rajeev Lalwani - *Morgan Stanley, Research Division - Executive Director*

Doug, a question for you. I appreciate the enthusiasm this morning, but what makes this time different versus before? I mean we've heard relatively bullish pitches from you at analyst day down in Dallas a couple of years ago. So what stands out this time versus then to sort of get the buy-in from investors and analysts alike?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Look, one you haven't heard from us before of these cash flow initiatives -- or the cash flow, I'm sorry, generation, because we couldn't say it before. Again it's not anything I feel particularly badly about. We needed to invest in this company. And we described at the time to investors that it was going to be significant. And the reality is, while we were making record profits, we weren't generating cash flow because we were spending it on upgrading our fleet. Of that $31 billion I talked about, in the last 6 years, $23 billion of that was spent on new airplanes. So that's behind us. So that's the new message. I don't know -- I don't think it's a change in bullishness. It's a new message and one that I think is important to our investors. So that's point one.

And the other -- only other -- what I'd add to the bullishness piece is our bullishness at the moment is not driven by us seeing anything differently than anyone else. It's driven by our absolute understanding that we -- our earnings this year were hindered by 2 circumstances that we fully expect to be behind us early in 2020. And our commitment to ensure that we have operational excellence and the growth prospects in, all of that has me excited. You should draw your own conclusions, but that's where we are.

Rajeev Lalwani - *Morgan Stanley, Research Division - Executive Director*

That's helpful. And then as a follow-up, this may for Derek as well. Broadly on labor, I don't want to talk about specific contracts, but broadly on labor, do believe that you've got to step up wages to get the buy-in of employees? I mean that was sort of the strategy at United. It seems to be successful for now. But maybe I'm not thinking about it or approaching it the right way that, that may be needed to deliver on some of what you're describing.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Yes, look, as we talk to our employees, the biggest thing we need to do for our team is provide a reliable operation. We -- and thanks to some great frontline leadership have done a really nice job of taking care of our team. We have, as you are well aware, needed to increase compensation across the board to get our wage levels to where their peers in other airlines are, because they certainly deserve to be paid really as much or more as those that are doing similar jobs at other airlines. But the issue we're dealing with now as it relates to the team is we need to give them the tools they need to do their job, which they do so incredibly well. That's go and take care of customers, and we haven't been doing that. When we don't run, we don't have operational excellence, our team ends up bearing the brunt of it. They end up not being where they're supposed to be. They end up having mandatory overtime. They end up having unhappy customers, all of which impacts their burnout. So what we know, and one -- and as important as operational excellence is to our customers and to our shareholders, it's really important to our team. And that's all of those reasons why we're so committed to making sure it happens. And we believe doing that will do more for our team than anything else we can do right now.

Operator

Our next question comes from Mike Linenberg from Deutsche Bank.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Doug, 2 quick questions here, I guess on fleet. Doug, the $8 billion to $10 billion reduction in net debt over the next 5 years, presumably there's no major fleet decision for American, probably out until '24, '25, that's kind of implicit in that. And if that is the case, what is the next aircraft type in the fleet that you're looking at that you would then have to address? What's the timing on that?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

I'm going to let Derek answer that.

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Yes, Mike, we will have -- the MD-80s will have gone out, the A190s will have gone out of the fleet, the 760s will have were gone out of the feet, 75s will eventually go out of the fleet. So the next real big decision for us is in the A319 category. Everything else will -- those aircraft are on average 15 years today. So as you said, we don't have any decision to make until '25 time frame. We might talk earlier. But I think it's really in that category, the 319 category, and what would be the replacement for that in our 320s at the bottom end, 150-seat range to 130-seat range.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

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And Mike, I also had a data point for you and everyone else. As we look at our fleet now, only 10% of our fleet, only 10% of our fleet is 20 years or older as compared -- contrasted to our 2 largest competitors who have about 1/3 of their fleets 20 years or older. So anyway, it'll be a while. We feel very good and indeed over half of our fleet is 0 to 10 years. So we -- again, it took us a while to get there and we had to spend a lot to do it. But we feel really good about where we are with our fleet and certainly relative to our cash needs versus our competitors going forward.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Agreed. Great position to be in. And then just my second follow up, on the A321neos, I mean you're obviously taking delivery of them now and into 2020. Given that you are, I think Airbus', you may be their largest customer for the A320 family right now just looking at your fleet and the potential, any chance that you can have those airplanes deliver out of Mobile rather than Europe as we move forward?

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

So yes, I would say -- this is Derek. And we have already a schedule out through the mid of 2020, where we'll have 9 coming out of Mobile, 6 of them are Hamburg today, and then we have still 6 to be determined. So we'll do everything we can. We have 21 deliveries in the next 2 years. We're doing everything we can to talk to Airbus to try to get them out of Mobile and make sure that those aircraft come from that manufacturing facility instead of Hamburg. But as of today, of the 21 we have coming, 6 come from Hamburg, 9 from Mobile and 6 yet to be determined which are late in 2020, that we'll continue to work to get those out of Mobile.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

But, Mike, implicit in your question, I think, is that if we didn't do that, that we would be paying the tariff as...

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Yes.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Well, you didn't say that, let me just assume you did.

Michael John Linenberg - *Deutsche Bank AG, Research Division - MD and Senior Company Research Analyst*

Yes, definitely.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

The -- yes, no, look, the -- we know, don't think, know, that the USTR placed the tariff at the level it did to ensure that the burden didn't get borne by U.S. airlines, but by the French. So we are happy to work with Airbus to mitigate that amount. But I don't think you should assume that if it's not mitigated, that American Airlines would be where it's borne.

Having said that, what we really hope is that we never get to that point. The answer to this is not to keep escalating and having tariffs on both side. The answer to this is for the European commission and the USTR to sit down and work this out in a way that doesn't have tariffs going both ways. But if they can't do that, this -- again, we are certain that the goal of the USTR was not to have these tariffs paid by U.S. airlines and then passed on to the U.S. citizens.

Operator

Our next question comes from Helane Becker from Cowen.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

I just had 2 questions. My first question is with respect to how you're intending to use Envoy and some of your other regional airlines for the capacity growth that you're doing in Dallas and Charlotte. And then my other follow-up question is, as you think about growing Latin America, which you've talked about in your prepared remarks relative to taking up that capacity that you're kind of losing with LATAM, is there space at Miami that do the same thing you're doing in Charlotte, DCA and in Dallas?

Vasu Raja - *American Airlines Group Inc. - VP of Network Planning*

Helane, this is Vasu. Let me get your questions in reverse order. First of all, space in Miami, yes, we have the space in Miami to grow in any number of ways, adding the 3 flights that Robert mentioned earlier is all accommodated within the capacity footprint that we have there. We have a really great position in Miami, a really great relationship with Miami airport and community at large. And so we -- the way we see this, as Robert said, that we will always have the biggest and the best Latin American network. It is at the very heart of our competitive advantage as an airline. And that's one thing that even through all of this stuff, we will continue to do and will continue to be able to go and operate in Miami and grow there. Though it doesn't have the profitability of markets like DFW and Charlotte, there are routes out of Miami that are among our most critical for our customers and certainly certain days of week and times of year, it's a really attractive marketplace for us. And you'll see us take full advantage of that in the year ahead.

To your first question about Envoy growth, which I think in part you meant Envoy, and maybe larger you meant kind of regional versus mainline. I'll speak to both. Our growth this past year has been heavily driven by the regional operation. Next year, it will be more heavily driven by our mainline operation. Our growth in Charlotte especially is less about growing our regional jets, it's about, one, improving the connectivity of the hub, making more O&D market; and then very critically, having more seats on all of those O&Ds. So you'll see us do things like bring the 737s in at a larger degree, turn more regional jets into main lines. We endeavor to do the same thing in DFW as well.

Now that said, our regional jet network is a very critical part of our airline. That does -- as we say, the little jets make the big jets go. And so there will be a big dose of regional jet growth as well. It'll just lag the mainline next year, whereas this year, it kind of outpaced the mainline.

Operator

And our next question comes from Dan McKenzie for Buckingham Research.

Daniel J. McKenzie - *The Buckingham Research Group Incorporated - Research Analyst*

If possible I would love to clarify the messaging on 2020. So CASM ex fuel flat next year, you expect to grow earnings. Investors are going to interpret that as your base outlook for unit revenues to be flat or up despite a pretty high capacity picture. So not asking for 2020 revenue guidance, of course, but just trying to make sure there's just no flaw here in the preliminary thinking.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Sounds like you are asking for revenue guidance. If we tell you CASM's flat and you ask if earnings are up, it sounds like you're asking for revenue guidance. But look, I want to go back to what we said so far, Dan. And we're not yet prepared to give you real guidance on earnings in 2020 because we're doing our own work and so we'll let you know more as we know more ourselves. Certainly, over the next call, we'll give you better guidance on the 2020 earnings forecast, but -- and you should do your own work on what you think about entering unit revenues and where we are relative to that. Right now, we can't give you much more than that.

Daniel J. McKenzie - *The Buckingham Research Group Incorporated - Research Analyst*

Yes, understood. Okay, had to try, of course. Okay, so good commentary, free cash flow demand, solid revenue backdrop. There is worry that the parallel universe, that the consumer today goes the way of the industrial sector tomorrow. I've had more than one conversation with owners about what American's earnings would look like in the downturn. And again I know that's not your message today, but can you talk about the fleet flexibility, so both narrowbody, wide-body? And is there a way to get ahead of the economic data points if they start to worsen?

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Yes, Dan, we have a significant amount of fleet flexibility. We have unencumbered aircraft of some 264 aircraft, almost 100 of those mainline, 172 regional. We have 65 deliveries to come next year, which we could deal with if we needed to. Lease extensions, there's about 47 of those that would come off. And then older aircraft, we have 53 of those, which most of those are in the unencumbered category. So we have upwards of 300, 350 aircraft fleet flexibility that if something happened, we could take the fleet down, if required, if there was some type of a recession or anything like that. But as I said earlier, we're not seeing anything like that in our bookings and things just continue to stay strong.

Operator

And we'll take our last analyst question from David Vernon with Bernstein.

David Scott Vernon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Question for you on the focus for 2020. Obviously, Rob and Doug, you talked about getting the on-time performance and the basic execution done and improved. I'm just wondering if there are specific things in the revenue pipeline that will help you to narrow that gap that you mentioned before on the unit revenue side with some of your peers.

Donald B. Casey - *American Airlines, Inc. - SVP of Revenue Management*

Yes, this is Don. Again, if you go look at our passenger unit revenue performance this year, in 2019, we did better than our, I guess competitors by about 1 point based on guidance for 4Q. That was based on the revenue initiatives we had in the pipeline this year, which also included our growing operation in Dallas, which we had in place the 1st of July. So as we look forward into 2020, we continue to have a pipeline of revenue initiatives. Obviously next year, big part of that is going to be the annualization of the growth in Dallas, adding the growth in Charlotte and we are going to be up-gauging and adding seats to airplanes, which is going to be very accretive to our overall revenue performance in 2020.

David Scott Vernon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Anything on the product side specifically that you could talk to, around whether it's some of the premium products or some of the other work you'd be doing on the cabin side that would help us kind of look for (inaudible) to get some upside?

Robert D. Isom - *American Airlines Group Inc. - President*

Yes, so Don, you can chime in here, but hey, what it is, is that we are finally getting to the point of being to offer instant upsell into higher level cabins. So as we've been improving our ability to segment, whether it's Main Cabin Extra or Premium Economy type seats, being able to offer that to customers in a convenient way is something that we finally have the technology to be able to do, and that was launched earlier this summer, expanded throughout the domestic, and now we're looking to move that not -- to international and also into other channels as well. So that's something that will absolutely help us take advantage of the product offerings that we have out there.

And to Don's point, in terms of being able to harmonize our cabins and ensure that we have the configurations we want, we had to take a hiatus because of operational issues this past summer on those programs. But those have been restarted and we anticipate that our 737 classic fleet will be fully upgraded by the summer of 2021.

David Scott Vernon - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Okay. And then maybe just a quick follow-up on the deleveraging that's going to happen over the next couple years. Is there anything you can tell us about the rates that you'll be retiring versus the rates you're paying on more recent debt? Like is there going to be any sort of a shift in effective interest rate as we're modeling out the next couple years of cash flow?

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

I would say -- this is Derek. I would say, no. I think our average debt is around 4% right now. So most of the higher priced debt we've paid off. It might be slightly higher of the old things that we're going to pay off because most of it is aircraft. That will include pension too. So we're going to take the pension down by about $3 billion in that calculation. So from an aircraft standpoint, it will be older aircraft that is probably up in the 5% range. A little bit higher than what our average cost of debt, but not significantly higher.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Just for clarification, Derek, the $3 billion in the $8 billion to $10 billion.

Derek J. Kerr - *American Airlines Group Inc. - Executive VP & CFO*

Yes, $3 billion is in the $8 billion to $10 billion, sorry, of the -- over the 5-year period.

Operator

And we'll now open up the lines for media to ask questions.

(Operator Instructions) And our first question we'll take is Alison Sider from Wall Street Journal.

Alison Sider

I was wondering if you could tell us anything about sort of the tone of the discussions you're having with Boeing around compensation. Is there progress being made? Or from your comments this morning, is there concern about an impasse there?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

Alison, I'll start. Again, the discussions are underway. But I guess I'd characterize the tone as early. I think not just -- no reason for us to be concerned at this point, but also no real clarity at this point. Much of the reason being from the standpoint of Boeing, still not certainty as to when the aircraft will be reserved by. So talks are underway, but they're early. But we feel highly confident that the losses that American Airlines have incurred won't be incurred by American shareholders, but will be borne by the Boeing shareholders.

Alison Sider

Got it. And are you concerned at all about any additional delays in return to service timing? And I guess, broadly, do you feel like Boeing, the leadership changes its made lately have gone far enough? Or do you think the company might have to do more?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

As to return to service, to answer that question, as to return to service, the date that we have of January 15 is based on the best information we have from talking to not just Boeing, but the FAA. We were encouraged to see Boeing announce, I think earlier this week, that they believe the aircraft will be certified in the fourth quarter. So that information, I guess, it's probably safe to -- it's probably best to describe that information as best case given what we have all seen over the course of this process. But it's a reasonable case, and therefore, if indeed that is -- that situation is correct, if indeed the aircraft is recertified in the fourth quarter, we absolutely -- we will be able to have our 5 airplanes, as Robert described, certified -- flying -- revenue flying as early as January 15. If indeed that doesn't seem to be the case, we will once again need to adjust. And we've -- we unfortunately are getting really good at that. We have designed this one in particular to be easier to do than others in that regard. So yes, we're frustrated, but it is hopefully getting to the point. It certainly feels as though the delays we hear about seem to be shorter delays, the confidence seems to be higher, but we don't take that as certainly anything close to it. But based on everything we know today, certainly, it seems reasonable to have these aircraft in our schedule, the 5 airplanes on January 15, and we are highly hopeful that'll be the case. If indeed that turns not to be the case, we will adjust and let our customers know well in advance.

Alison Sider

Got it. And on leadership?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

No comment.

Operator

Our next question comes from Dawn Gilbertson from U.S.A. Today.

Dawn Gilbertson

Two questions. One, Robert, you mentioned under consumer initiatives, new technology, I think you said related to helping families sit together. Could you go into any detail on that? And my second question is seat fees are really prevalent right now. And I'm wondering where that -- if you can give any sense of the revenue opportunity there and where that ranks right now in terms of ancillary revenue?

Robert D. Isom - *American Airlines Group Inc. - President*

Dawn, I didn't hear the second part of the question. The first part, just in terms of seating families together, I'll just say this, we've always had technology to help, we've improved our algorithms, and ultimately, we're getting a much better hit rate of making sure that we protect and we reserve seats for those families. And so there's good things on that front, but all technology-based and really enhancements to processes that we have in place today. But now as it works, the second part of your question was, I didn't hear, (inaudible) seat fees. Did you say?

Dawn Gilbertson

I wanted to get a sense of the scope of, you started these preferred seat fees and all airlines have them now pretty much to one degree or another. And it seems to me that's got to be a pretty big revenue, you're bringing a lot of money from these preferred seat fees. And I'm just wondering if you can give us any sense of the scope of that, where you plan to take that, and where that ranks now in -- kind of in the ancillary hierarchy?

Donald B. Casey - *American Airlines, Inc. - SVP of Revenue Management*

Yes, this is Don Casey. We've done quite a bit on the seat side, one is just introducing different products. So the Main Cabin Extra, we did a relaunch with enhanced benefits a year ago. That has proven to be very successful. And again, there are customers who do have the willingness to pay, right, a bit more for better product, and that's what we're finding out in the marketplace. So we're continuing to expand the product portfolio with better products out there and provide better capabilities for customers to buy up even those better products and we're seeing good demand. Seat fee revenue today is now our second largest ancillary revenue stream after bags.

Dawn Gilbertson

If I could just ask just a quick follow-up related to that. When you say seat fee revenue, does that include -- so that includes your preferred seat fees where you get nothing extra and also Main Cabin Extra? Or what's in that basket?

Donald B. Casey - *American Airlines, Inc. - SVP of Revenue Management*

It's basically every additional charge a customer is willing to pay for a better seat on the airplane. So in the case of preferred seats, those are aisles and windows and close to the front, and Main Cabin Extra, it's extra legroom, a free drink and better dedicated access to bins and early boarding.

Operator

And our next question comes from Tracy Rucinski from Reuters.

Tracy Rucinski

Doug, I was wondering, what is your own position on the Boeing employees instant messages about MCAS and the simulator and the e-mails that referred to not including mention of MCAS in the flight manual?

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

We don't have a position on that. Our position is we're highly interested in having the airplane -- Boeing meet the requirements of the FAA and getting the airplane recertified. I will note, we think that FAA has been -- is doing a fantastic job with this process and is showing real leadership, as they always do, on safety in aviation. And we feel really confident that once the FAA recertifies this airplane, it'll be the safest in the world and we are looking forward to that day.

Operator

Our next question comes from Edward Russell from The Points Guy.

Edward Russell

Vasu, I wanted to ask about what you -- about your comments on Chicago, you mentioned offering more first class seats than competitors and then you talked about shifting to more A319s in 2020. However, my understanding is A319 only has 8 first class seats versus some of your dual seat aircraft of 12 competitors offering 10 on their new dual aircraft -- dual-class aircraft. Talk a bit more about what the strategy is to attract business travelers in the Chicago market.

Vasu Raja - *American Airlines Group Inc. - VP of Network Planning*

Yes, Ed, great question. And importantly, the 319 has 8 first class seats. Anytime we're taking out a single class 50 seater and replacing with bigger jet, you're of course going from 0 first class seats to something more than that regardless of what it is. So but with that in mind, really there's multiple things that we plan to do in Chicago. One of which is, look, we have a luxury in Chicago that our competitor doesn't have, which is that we have a gigantic East-West hub in DFW. For our competitor, that is the best East-West hub that they have. And so what we're really interested in doing is being able to provide the best product and schedule to the customer of Chicago to the world. And we'll increasingly do this as we move through a number of our fleet initiatives and product initiatives too. We will have better schedules on the key days that business travelers go. We'll vary the capacity levels that we have through the course of the week. And then over the long term, what we will increasingly do is as we do more 50-seat replacements, you'll see more and more 2-class services, whether it's larger RJs, 319s or 737s coming into Chicago.

Donald B. Casey - *American Airlines, Inc. - SVP of Revenue Management*

And I'll just add -- it's Don, that customers right now, I mean they like our product in Chicago and we're seeing it in the numbers. I mentioned earlier, our unit revenue in Chicago was the highest of any hub we had. And we grew our corporate passenger volumes in Chicago in the third quarter by 7%. So customers like the product we have there right now.

Edward Russell

Okay. So just to be clear, I'm understanding, the 50-seaters will come out, 319 and those 50-seat markets will step up to 76-seaters and those are the 319 -- that's kind of the idea, sort of a cascade [almost going]?

Robert D. Isom - *American Airlines Group Inc. - President*

Yes, Ed. Over time they will, and we're working through what that looks like. And I think at this point, we're probably not yet ready to reveal all of it. But that is our long-term plan. That's long been our fleet plan and markets like Chicago are exactly the kinds of the things we have in mind for it.

Operator

And that does conclude our question-and-answer session for today's conference. I'd now like to turn the call back over to Doug Parker for any closing remarks.

William Douglas Parker - *American Airlines Group Inc. - Chairman & CEO*

All right. Thank you all very much for your interest. And we appreciate it. And if you have any questions, either contact Investor Relations or Corporate Communications, we'd be happy to answer. Thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a wonderful day.
