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EDITED TRANSCRIPT

AAL.OQ - Q2 2023 American Airlines Group Inc Earnings Call

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OVERVIEW:

Company reported net income of $1.4 billion, adjusted earnings of $1.92, adjusted operating income of $2.2 billion, operating cash flow of $1.8 billion, cash flow of $1.2 billion, free cash flow of $4.3 billion, available liquidity of $14.9 billion, total debt of $387 million, net debt of $955 million, total debt of $9.4 billion.

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PRESENTATION

Operator

Thank you for standing by, and welcome to American Airlines Group Second Quarter 2023 Earnings Call.

(Operator Instructions) I would now like to hand the call over to Scott Long, Vice President of Investor Relations and Corporate Development. Please go ahead.

Scott Long *- American Airlines Group Inc. - MD of IR*

Thank you, [Atif.] Good morning, everyone, and welcome to the American Airlines Group Second Quarter 2023 Earnings Conference Call.

On the call this morning with prepared remarks, we have our CEO, Robert Isom; and our CFO, Devon May. A number of our other senior executives are also in the room for the Q&A session. Robert will start the call this morning with an overview of our performance. And Devon will follow with details on the second quarter and will outline our operating plans and outlook going forward. After our prepared remarks, we will open the call for analyst questions followed by questions from the media. To get in as many questions as possible, please limit yourself to 1 question and 1 follow-up.

Now before we begin today, we must state that today's call contains forward-looking statements, including statements concerning future revenues, costs, forecast of capacity and fleet plans. These statements represent our predictions and expectations of 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 that was issued this morning as well as our Form 10-Q for the quarter ended June 30, 2023.

In addition, we'll be discussing certain non-GAAP financial measures this morning, which exclude the impact of unusual items. A reconciliation of those numbers to the GAAP financial measures is included in the earnings press release, which can be found on the Investor Relations section of our website. A webcast of this call will also be archived on our website. The information we're giving you on the call this morning is as of today's date, and we undertake no obligation to update the information subsequently. Thank you for your interest and for joining us this morning. And with that, I'll turn the call over to our CEO, Robert Isom.

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Thanks, Scott, and good morning, everyone. The summer is well underway, and the American Airlines team is firing on all cylinders. We continue to build on the strong foundation we have laid over the past year and remain focused on reliability, profitability, accountability and strengthening our balance sheet.

That focus is showing up in our results. Everything we have said we would do at the start of the year, we have done. Our operation is performing at historically strong levels. And this morning, we reported adjusted pretax earnings of approximately $1.8 billion for the second quarter. These earnings were well above the high end of our latest EPS guidance range, marking our fifth consecutive quarterly profit. At the start of the recovery, we told you that returning to profitability hinged on running a reliable airline. American continues to run a strong operation in an evolving environment in which we are very well positioned because of the hard work our team has done in recent years.

Our sustained profitability is tied to our leading network rewards program and operation. We have a tremendous network and we operate in a reliable and efficient way, and we reward our customers for using it. Now let's talk more about our financial results. We produced total revenue of $14.1 billion in the second quarter, the highest quarterly revenue in our company's history. This was driven by broad-based demand across all entities with a particular strength in demand for international travel leading into the summer. Throughout the recovery, we have made structural changes to enhance our customers' travel experiences and position the airline for success. We have simplified and harmonized our fleet to create a more nimble and more flexible network that is focused on our most profitable flying.

American strength is our network, which is uniquely positioned to capitalize on the demographic changes in the U.S. More people have moved to the Sunbelt region, which is where some of our largest hubs are located. DFW, Charlotte, Miami and Phoenix are very well positioned now and for the future. Our strong regional network provides service to smaller accounts and connects them with our hubs across the country, and our global partnerships are a great complement to our own flying. As a result, we are able to offer customers the most comprehensive network of any U.S. carrier.

We continue to adapt our offerings to our customers' evolving preferences. We are taking customers to where they want to go and meeting them where they want to do business. We are servicing more of our customers through our direct channels and driving engagement in our advantage program and credit card portfolio. Our Travel Rewards program is the largest among the U.S. network carriers, and it continues to grow. We are making terrific progress in training our pilots and improving the utilization of both our mainline and regional fleet. Our young fleet and low near-term CapEx requirements enable us to generate free cash flow to reinvest in the business and strengthen our balance sheet.

Now turning to the operations. The American Airlines team has delivered strong operational results over the past year, and it continued as we achieved record second quarter completion factor. We operated nearly 0.5 million flights in the quarter with an average load factor of approximately 86%. In the second quarter, we also delivered 11 more combined 0 canceled days in the same period of a year ago. The summer peak started strong with our team delivering our record Memorial Day weekend mainline completion factor while operating our largest mainline Memorial Day weekend schedule ever. The momentum has continued into July. We delivered the best Independence Day holiday operation in our history, with traffic levels we haven't seen since July of 2019.

At American, we're focused on taking care of what we can control. Our purposeful approach to planning, along with our investments in our team, fleet and technology has set us up for success during the busy summer travel season and beyond. And now I'll hand it over to Devon who will share more about our second quarter results and the outlook for the remainder of the year.

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

Thank you, Robert. The focus and dedication of the American Airlines team has resulted in strong operational performance which is helping to produce solid financial results. Once again, we delivered on our guidance for the second quarter. Excluding net special items, we reported second quarter net income of $1.4 billion or adjusted earnings per diluted share of $1.92.

Our strong operational performance resulted in slightly higher capacity production for the quarter and CASMx performance better than the midpoint of our forecast. Unit revenues remained strong, resulting in an operating margin and EPS that outperformed the high end of our guidance provided in May. As Robert mentioned, American produced record revenue of $14.1 billion in the second quarter, up nearly 5% year-over-year. This revenue performance led to our highest ever adjusted operating income of $2.2 billion resulting in a second quarter adjusted operating margin of 15.4%.

Unit revenue in the quarter was down just 0.5% versus a historically strong 2022 on 5.3% more capacity. Domestic unit revenue was down 1.9%, while international unit revenue was up 18.3% year-over-year. Our unit cost for the quarter, excluding net special items and fuel, was up 3.7% year-over-year. That's better than the midpoint of our initial guidance range due to slightly higher than planned capacity production driven by our strong operational performance. I want to spend a few minutes updating you on our fleet. Our young and simplified fleet differentiates American from our U.S. network peers and provides network flexibility, enhanced efficiency and an improved customer experience. These benefits are the result of the refleeting we pursued from 2014 to 2019 and accelerated during the pandemic.

We are pleased we built our fleet in a low interest rate environment and at a time when the supply chain wasn't as challenged as it is today. In 2023, we expect to take delivery of 23 new mainline aircraft which are all now financed. We took 13 deliveries in the first half of the year and expect 10 more aircraft to be delivered by year-end. For our regional fleet, this quarter, we entered into agreements to purchase 7 new Embraer 175 aircraft and 7 used Bombardier CRJ 900 aircraft that will be delivered starting in the fourth quarter of this year. We're excited to have these aircraft into service and to further bolster our regional connectivity. Based on the latest delivery guidance from Boeing and Airbus, along with our new and used regional aircraft purchase commitments, our 2023 aircraft CapEx is now expected to be approximately $1.7 billion. Our non-aircraft CapEx is still expected to be approximately $800 million. We anticipate our 2024 total CapEx to be between $3 billion and $3.5 billion.

Looking beyond 2024, we continually review our medium- and long-term fleet plans. Due to the young age of our aircraft, our fleet replacement needs are very limited. Therefore, we expect aircraft CapEx for the next several years and likely through the end of the decade to average approximately $3.5 billion per year. Moving to the balance sheet. Yesterday, Fitch upgraded Americans credit rating. This is the first step towards our goal of BB credit metrics by the end of 2025, and it's nice to see our progress being recognized. We continue to maintain strong liquidity. In the second quarter, we generated operating cash flow of nearly $1.8 billion. Our adjusted net investing cash flow was approximately $550 million, resulting in quarterly free cash flow of $1.2 billion.

We have produced $4.3 billion of free cash flow in the first 6 months of the year and expect full year free cash flow to be approximately $3 billion. We ended the second quarter with approximately $14.9 billion of total available liquidity. We continue to make progress on strengthening our balance sheet in the second quarter by reducing total debt by $387 million. This debt reduction, combined with the improvement in liquidity, resulted in a decrease in net debt of approximately $955 million during the second quarter. We have now reduced total debt by approximately $9.4 billion from peak debt levels in 2021, which is significant progress towards our goal of reducing total debt by $15 billion by the end of 2025. By the end of 2023, we expect our total debt to be approximately $11 billion lower than peak debt levels in 2021.

Importantly, we ended the second quarter with a net debt-to-EBITDA ratio of 3.8x, which is lower than it was at the end of 2019. Now turning to our guidance. Bookings remain strong, and we continue to see a constructive demand environment. We saw record revenue for the fourth of July holiday period and booked load factors for the third quarter are in line with what we saw in 2022. International entities continue to lead the way in terms of year-over-year performance, and we are encouraged by domestic business demand, notably from small- and medium-sized enterprises.

As the recovery continues to unfold, the strong unit revenue environment in 2022 represents an increasingly difficult comparison. As a result, we expect third quarter TRASM to be down 4.5% to 6.5% year-over-year on 5% to 7% more capacity.

We expect third quarter CASMx to be up 2% to 4% year-over-year. Our current forecast for the third quarter assumes a fuel price between $2.55 and $2.65 per gallon. Based on our current demand and fuel price forecast, we expect to produce an adjusted operating margin between 8% and 10% in the third quarter and adjusted earnings per diluted share between $0.85 and $0.95, excluding special items. For the full year, we continue to expect to produce capacity that is 5% to 8% higher than 2022. Our full year forecast for unit revenue continues to be up low single digits year-over-year. We now expect our full year CASMx to be up 2% to 4% versus 2022. Notably, our expectations for capacity TRASM and CASMx are all consistent with the initial guidance we provided on our January earnings call. That said, our estimate for full year fuel expense has changed.

We now expect to pay between $2.70 and $2.80 per gallon, a reduction from our initial guidance. The full year update further highlights the positive environment we are operating in. Based on our demand and fuel cost assumptions, we expect to produce a full year adjusted operating margin of between 8% and 10% and adjusted EPS of between $3 and $3.75. We are very proud of the progress the American Airlines team has made, but we believe there is more opportunity ahead of us. We will continue to focus on delivering in 2023 and unlocking even more value in 2024 and beyond. I'll now turn it back to Robert for closing remarks.

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Thanks, Devon. The American Airlines team is delivering on our commitments. We're on track to deliver on the full year guidance we provided back in January, driving earnings growth, record free cash flow, meaningful debt reduction and importantly, a strong and reliable operation.

We are executing on that plan. We are reliable, profitable and making tremendous progress strengthening our balance sheet and I know that our team will continue to deliver. We're excited to share more about our long-term strategy at an Investor Day later this year on our Fort Worth campus. We look forward to updating you on the business and sharing more about our longer-term strategic priorities at that time. We're incredibly excited about the future of American and can't wait to tell you more. Operator, please open the line for analyst questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jamie Baker of JPMorgan.

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

So, Vasu, you spoke enthusiastically last year about the EMEA. You admitted New York had been a challenge for decades. But you were finally seeing New York RASM outpaced the system. And now it appears that, that all reverses. I'll admit my earnings model doesn't model you by hub. But if it did, why shouldn't I assume New York reverts to being a meaningful margin drag from this point forward?

Vasu Raja

Jamie, thanks for the question. First, I would say that we don't anticipate it being a margin drag. And for full clarity, though it's unfortunate the NEA is terminated. Our commitment to the customers in the Northeast and New York specific hasn't changed. However, the circumstances that gave rise to the NEA have changed.

At one point in time, we struggled with really 2 major things. One, our slot holding didn't match with the demand one that is the majority of demand in New York was for short-haul day trip business market. Our slot portfolio is better matched Mid-Continental, Transcontinental and Transatlantic market. Well, that's changed. Short-haul business demand hasn't recovered to its historical level, but those other markets are much greater. And so that's a material change from before. But also our expense base, especially in New York Kennedy has changed. Through co-locating partners and any number of fleet changes, our employment expenses in JFK are materially advantaged to what any other carrier is in New York.

So what that means for us is though it's unfortunate that customers don't get the experience of having a much broader network than what was there before, it was a practical matter for American Airlines. We very much expect preserve the continued margin trajectory that we've been on. And as we go forward, we'll certainly share more, but it's very much our plan and our intention that we continue to go see more New York City originating customers flying with us.

And so far, since the NEA has been announced, we've seen that. NEA enrollments in the Advantage program continue to rise. Credit card acquisitions continue to rise, spending continues to rise. So though -- this chapter is closed, another one might open, but we don't expect any material change to our financial outlook.

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

Okay. Very helpful. And then, Devon, on the cost side, recognizing there are lots of moving pieces in the full year CASM guide. Can you tell us the last time you adjusted the labor accruals that you're assuming? And also does your full year cash flow guide include retro pay for the pilots.

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

Yes. So on the cash flow, it does include the retro pay that was part of our -- that is part of our tentative agreement that we have with the pilots today. As we talked about last quarter, what we have for an accrual is, we are accruing wages that were agreed to in May as part of the agreement in principle starting on May 1, and we expect the agreement -- or hope the agreement will ratify here in August, at which time, we'll go to the new rates and the benefits associated with that kind of agreement.

Operator

Our next question comes from the line of David Vernon of Bernstein.

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

So Robert and Devon, first question for you on the guidance framework you kind of laying out for us here for the back half of the year. It does sort of imply a pretty material deceleration from your earnings level in 2Q to 3Q. And we're hearing from you guys that the demand is good. The team is executing, you're delivering on your cost performance. Can you talk a little bit about the thinking behind how you're laying out the guidance here. You just had a huge beat to your 2Q guide. You haven't missed in a couple of quarters. I'm trying to understand like are you guys just kind of keeping the bar here where you said it in the beginning of the year, or is there something that's really kind of decelerating here in the back half?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

David, thanks for the question. Look, we've set out clearly focused on producing profitability and our reliability is -- our operating reliability has actually really facilitated that. As we take a look at it over the course of the year, you'll see that we actually raised the midpoint of our full year guide by a quarter. It's indicative of our belief that the economy is strong, demand is strong. And for us, look, there's seasonality certainly involved. But at the same time, we're looking at this over the course of the year, and we're going to stay the course, and we feel really positive about the results that we reported and what's coming. And Devon, do you want to add anything to that?

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

No, I think same points. We started the year and set our objectives for the capacity we're going to produce, the unit costs we're going to produce it at and our earnings levels. We're really happy with what we've accomplished in the first half of the year. The guide we have in place did increase our full year EPS to $3 to $3.75, and we feel really good about upping that number.

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

Okay. And then maybe if you could talk a little bit about sort of the domestic outlook here in the 3Q. You've got, I think, 34% capacity growth in domestic and short-haul international. How are fare trends kind of moving sequentially. There's a lot of concern, I think, in the market about deceleration in the domestic travel market. Can you kind of elaborate a little bit more on kind of what you're seeing and what you're embedding into the 3Q guide for domestic?

Vasu Raja

Sure thing. This is Vasu. First, look, I'll say at large. We continue to remain encouraged by the overall level of demand we see, especially in domestic and short haul. If you look at air travel spend as a percentage of GDP, certainly (inaudible) retained its relationship revenue, even domestic revenue as a percentage of GDP continue to regain their former relationship to demand.

But for us, it's really important to note is this recovery is continuing to unfold. And as we look out there in domestic, a lot of the sequential change that you see is really due to some pretty unique things. About a point on the 2Q to 3Q changes just due to calendar shift. And another point is due to our operational outperformance in the second quarter. Everything else is really a return to normal seasonality. As far as a deceleration of demand or things like that, we don't yet see it now. And in fact, when you look at it for us, like versus 2019 or some base where you lose, just the strange comparisons to how recoveries have unfolded.

For us, as we get into the fall, and we will be flying an airline (inaudible) bigger than 2019 airline but producing short-haul RASMs that are 15% to 20% higher. So there's still -- we're still in a world where demand is very strong. The year-over-year comps are a little bit strange, owing more to just the vagaries of the recovery than anything underlying the business.

Operator

Our next question comes from the line of Scott Group of Wolfe Research.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Analyst*

Sorry, I lost my voice. But hopefully, you can hear me. I just want to go back to the third quarter guide. So we've just never seen margins go from 15% to 8% to 10%, down 5 to 7 points from Q2 to Q3, just any more color to help us think about what's driving that?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Scott, again, I'll tack on to both Vasu's comments and Devon's as well. We're looking at our results over the course of the year. The recovery, as we've seen it has been not exactly smooth on a quarter-to-quarter comparison basis. As we take a look at the year, you can depend on us to produce those results. We're really proud of those. And it's indicated by us, again, moving our EPS guide up as we did this morning.

Scott H. Group - *Wolfe Research, LLC - MD & Senior Analyst*

Okay. And then just to clarify, is there -- are we assuming any earnings impact from losing the NEA, which is I know it sounds like you don't think we go back to where we were. But is there any earnings impact going forward from losing NEA?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Scott, we're not anticipating any earnings impact.

Operator

Our next question comes from the line of Conor Cunningham of Melius Research.

Conor T. Cunningham - *Melius Research LLC - Research Analyst*

Not a lot of talk on blended travelers or blended itineraries this quarter. Just curious on -- is that just because it's in your base now? And maybe you could just level set us on how you're thinking about large corporate in the back half of '23.

Vasu Raja

This is Vasu and thanks for the question. And you're exactly right. It's less of a novelty now. This is just part of our base, how the business runs for several quarters now. We've seen a mix of 35% leisure style travel, 35% blended style travel, 30% (technical difficulty) And furthermore, within the 30% business, there's roughly a 2:1 split between unmanaged travel and managed travel that's there.

That's been pretty consistent for several quarters now. It looks to be pretty consistent going into the future. Certainly, that's what our forward book says. So that's why no commentary. This is actually how the business operates now.

Conor T. Cunningham - *Melius Research LLC - Research Analyst*

And just what you're thinking about corporate, sorry?

Vasu Raja

Look, we've seen corporate -- first of all, I'll clarify this. When we talk about business, we talk about people on business style trips. And within that, there's 2 groups, there's individuals and companies that fly, they don't manage or buy their travel centrally. And then there's large corporations that tend to manage by their travel centrally.

We've seen that those customers who were managed, they buy their travel centrally has -- it's recovered to 80% of historical levels. That's been pretty much plateaued for several quarters now. However, unmanaged demand continues to grow in our system. And indeed, total business revenues have really regained their 2019 composition in the system. So we remain encouraged on business demand. Should things change, we're prepared to go and adjust accordingly. But no forward change to outlook is any different than the stuff we've been experiencing.

Conor T. Cunningham - *Melius Research LLC - Research Analyst*

Okay. And then just on the competitive environment in the domestic market, the ULCCs and LCCs have been ramping capacity in the back half and a lot of that's hit in your hubs. I'm just curious on how you view the competitive landscape right now as you think about the back half of '23.

Vasu Raja

And look, we actually view the competitive landscape very favorably. Our network proposition to our customers is creating more origin and destination markets and more unique origin and destination markets than any other airline network. And we have done that really well. We continue to do that really well. That's really been the (technical difficulty) financial progress that we've seen.

And to Robert's comments with roughly 70% of the airline network is located in the Sun Belt in our Latin America network and London Heathrow in places where we really deliver a lot of outsized value for customers. And there, while we do see competitors come in, we remain encouraged. Take any number of those markets in our short-haul Latin American markets. We've seen something like 20%, 25% industry capacity growth, but the trends are favorable enough where this fall and winter will fly our largest schedule there, not because we're out to chase market share, but because of the marginal performance of those routes.

Operator

Our next question comes from the line of Helane Becker of TD Cowen.

Helane Renee Becker - *TD Cowen, Research Division - MD & Senior Research Analyst*

Robert, I thought I heard you say on CNBC this morning that you're meeting with your pilots to talk about matching the United contract. Did I hear that correctly, A? And B, do you have to let them vote and reject the contract that they're voting on now? Or can you adjust it and they vote on any changes you might want to make?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Helane, thanks for the question. Look, in terms of how we actually are able to deliver to our products, that's going to be something that we have to work on with them, and we're in discussions with the APA right now, as a matter of fact. What I said this morning is something I'm really proud of and that we're committed to.

Look, we're going to match the wages that United is proposing. We've got to sit down and (technical difficulty) to figure out whether or not that is something that they can fit into their TA that can still be voted on, on a timely basis or if it's something that's going to take more time to figure out. But we're committed to matching those wages.

Helane Renee Becker - *TD Cowen, Research Division - MD & Senior Research Analyst*

And then just shifting gears for a minute. You guys have been delivering a really great operation for the past, I don't know, at least 3 quarters, right, as somebody who's shifted from New York to Philadelphia. I can see it in my flying. And I'm just kind of wondering, are you seeing that also in your Net Promoter Scores? Can you talk about what customers are seeing? And are you seeing any share shift from any of your competitors to yourselves?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Well, Helane, thanks for bringing it up. We're really proud of the work that we've done over the last year. It's just a tremendous and relentless focus. It's led by David Seymour, our Chief Operating Officer. And every day, our team is out there, including today, in this ridiculous heat and weather, they're just performing.

We've done everything from training to adding new (technical difficulty) And when things go awry, we have been really quick to make sure that we have the tools necessary to put things back in place, whether that be aircraft or our crews. And that's going to continue. I anticipate that we're

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going to get better and better. Of course, that translates into likelihood to recommend scores, in Net Promoter Scores that are the best that we have ever seen. And I have great confidence that is something that we will continue to play out. That relationship between reliability and what customers really want is super evident.

Operator

Our next question comes from the line of Brandon Oglenski of Barclays.

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

Vasu, I want to come back to the unwind of the NEA because it does look like you have quite a bit of international capacity you've added at JFK. But not a lot of domestic connectivity on your own network. And I think JetBlue was part of that answer historically. So can you talk to what the long-haul strategy looks like out of JFK going forward?

Vasu Raja

Yes. Thanks for the question, Brandon. Look, there were really 2 issues that we had in New York. One was the amount of connectivity support that we had for our long haul and the other was just the huge expenses we had operating out of New York Kennedy. As I mentioned earlier, we've done a lot of things to go and reduce our expense base to where, it's not just more in line with our other low-cost hubs but it's materially lower than what any other operator has in New York City.

But also -- and this is meaningful to it. Look, the NEA was a great outcome for customers who got to go and experience our product who weren't there before. But actually, when you look at those international flights, roughly, as things have settled out and markets recover, roughly 35 to 40 points of the load factor that's on them is actually being generated by international partners. Our partnership within the NEA was actually a very small amount of the onboard load factor that's there.

That's why when we couple both the expense reduction that's there and some changes that we can make ourselves, we believe that we can go and really replace a lot of the demand, especially now that we've got such a larger New York City originating customer base than what we had before.

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

I appreciate that response. And I guess maybe a quick one for Devon because I think you mentioned aircraft purchases out in the future could be around $3 billion to $3.5 billion annually, if I heard it correctly. Do you think strategically, that's the right level of reinvestment in the business, especially given that some of your competitors might be spending a bit more than that?

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

Brandon, yes. So the comment was we think we'll have somewhere around $3.5 billion on average of aircraft capital beyond 2024 and probably for a good part of the decade. And where we are different than our competitors is we don't have any fleet replacement needs between now and the end of the decade, so when we are investing in an aircraft, that is an investment to grow the network and to grow the airline.

What you're seeing from some of our other competitors who just have older airplanes, there's a lot of fleet replacement CapEx required for them. And again, for us, it is just growth aircraft requirements.

Operator

Our next question comes from the line of Duane Pfennigwerth of Evercore ISI.

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

I'm really tempted to ask another NEA wind-down question, but we'll leave that for off-line. Maybe just on fleet. Where do you think your biggest gap or constraint is at the moment? Like where do you wish you could be bigger today? And can you talk a little bit about -- I think you mentioned some regional fleet adds. What are the kind of staffing circumstances you see that are allowing you to invest there?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Thanks, Duane. Just a couple of things. Look, I think as you take a look at the industry and especially our needs at American, we're going to need larger narrow-bodies in a number of places. It just fits with how our hub structure works and all the kind of things that Vasu wants to do. I would add to that, though, that probably our biggest and most interesting opportunity right away is getting our regional fleet fully back up in the air.

And those aircraft only further our commercial proposition by adding more small markets to what is a great hub-and-spoke system already. So as we take a look out into the future, you'll see us make sure that we protect ourselves and that we are able to not only replace an upgauge from a narrow body perspective but also have an eye to be able to grow at a rate appropriate for demand levels.

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

And then just for my follow-up, could you just remind us maybe some of the differences in your Transatlantic geography versus peers? And maybe it's too fine of a point, but could you contrast kind of your Southern Europe exposure relative to Delta and United?

Vasu Raja

Thanks for asking them. Look, and for us, so much of our Transatlantic and I'll just speak to the European content at this point, not other things that sometimes get lumped into reporting such as Middle East or India. But for us, a lot of our concentration is, first and foremost, in London, probably much more so than what other airlines are. And that which is in Southern Europe is really heavily seasonal style flying or as we call it, the large city or the large capital market, things like Rome and Athens, Barcelona and Madrid.

So we've done a lot over the last several years to actually -- further to Devon's earlier point, to really restructure our international network. We used to fly a lot of really marginal flights to really marginal markets. They work for 3 months of the year and we had nothing to do with the airplane for the other 9 months of the year. So we've used the last 3 years to go and rebuild the foundation, the bottom 5% of our capacity is gone, the fleet that goes with it is gone and the losses that we took from it are gone. And so now what we're building back to Devon's point of just moderate growth is adding things that really make sense and are a good use of full year aircraft capital.

Operator

Our next question comes from the line of Andrew Didora of Bank of America.

Andrew George Didora - *BofA Securities, Research Division - Director*

First question, Devon, I just wanted to make sure I was clear in terms of what is in your CASM outlook for this year. Does it just include the step-up in pay rates beginning May 1 from the TA? Or do you also factor in a step-up in profit share and work rules? Just want to be clear on what's included there.

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

Yes. So right now, what's included in our guide is pay rates from May 1 through the end of July. And then starting in August, we hope to have ratification of the tentative agreement. And at that point, we'll have pay rates and all the benefits that go along with it, including the higher profit sharing.

Andrew George Didora - *BofA Securities, Research Division - Director*

Got it. And then Robert, I know it's early on, but just when you think about 2024, any initial thoughts on how you're thinking about capacity and the way you kind of -- the continued build-out of both your domestic and international networks. Just curious which entity you think could -- between domestic and international could be growing the most next year and just how you think about growth.

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Thanks, Andrew. Right now, it's -- we're in the planning stages. But what I'd tell you is that based on the kind of fleet that we have, we would have anticipated mid-single-digit growth for next year. Now there's a lot of dependencies on that.

So first off, we have to be able to get our regional fleet back up fully that requires pilots. We've -- to be able to achieve that kind of level of flying we would have to also get a little bit more out of the aircraft we have in terms of utilization as a whole. And the final thing is we're dependent on the airframe manufacturers to actually deliver. They're getting better, their track record hasn't been great. So we'll see how that shakes out. And if it all comes to fruition, that's probably a pretty good guess at this point.

Operator

Our next question comes from the line of Michael Linenberg of Deutsche Bank.

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

Congrats on the 2-notch upgrade from Fitch. I guess 2 questions here. I guess Vasu, just with the rollout of your new distribution strategy, any early learnings direct versus indirect. I sort of caught the 2:1 unmanaged versus managed on your corporate piece. I think if we go back historically, they were probably more evenly divided. So it seems like there's a bit of a shift there. Whatever you can tell us and then I have a follow-up.

Vasu Raja

Thanks, Mike. It's an excellent question. I was wondering when it might be asked. Look, first of all, all of our selling and distribution changes are done with a really simple lens, relative to which Robert talked about in his opening remarks. We want to make it as easy as possible for our best customers to be able to shop by and self-service their experience with American Airlines.

And everything has been oriented around that. It has indeed been very eye-opening and has performed probably above what our expectations are. The simplest way to get (inaudible) is like this. If you take all of our customers, the actual human, you can divide them into 2 groups, those who are not members of the Advantage program and those who are members of the Advantage program. In the quarter, for those customers who are not members of the Advantage program, indeed, their total travel fell 5%, but revenue from that cohort grew by 5%.

And amongst the customers who are advantaged customers, we actually grew their transactions by 8% and their revenues by 13%. That is certainly above what we had expected, but also what we're really encouraged by our 3 things: first, for every -- there's a high level of attachment for all of our advantage customers. For every dollar of flight revenue they bring in, they bring in about $0.10 of other revenue primarily on a branded credit card. Two, the cost of sale is materially lower amongst our advantage customers. It's not just that we're paying less in booking fees and commissions and things like that. But what we've found is something like 25% to 30% of our calls to reservations are actually bookings at a travel agency originated and is, for some reason, unable to go in service. So there's a lot of implicit savings that we see from it.

And last and maybe most importantly, we're encouraged by what we see is really the durability of these customers' demand. These are customers who tend to use our network where it's most unique. They fly more times in a year. They already have bookings out into the fall. They tend to sell themselves up. And importantly, they prefer coming to us direct. So we're currently in taking roughly 70% to 75% of our revenues going through our direct channels. We anticipate that will grow. We're encouraged by this, and we're actually going to continue to accelerate the changes. By the end of the year, 100% of what we sell, customers will be able to service online through our app or our dot-com.

We'll roll out those features also over time for new distribution technology. But as this happens, we'll make increasingly less and less of our fare content available through traditional technology where customers aren't able to get that quality experience they're looking for from us.

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

Great, awesome response. And then just my second question, I guess, is to you as well, when I sort of look at it in the forward schedules, it does look like even up to summer of next year, that JetBlue is still maintaining a significant presence in LaGuardia. And so presumably, you will still continue to lease those slots to them and maybe maintain a smaller presence in LaGuardia than what you had pre-NEA? Or is that just -- are those placeholder schedules and that's TBD?

Vasu Raja

Yes, Mike. A lot of that is TBD right now. And in fact, Priya Aiyar, is here our General Counsel. We're still in a process of determining how to wind down the NEA, most notably how we transfer back all of the slots to American Airlines as soon as we can.

Operator

Thank you. Ladies and gentlemen, we will now move to media questions and answers.

(Operator Instructions) Our first question comes from the line of Alison Sider of Wall Street Journal.

Alison Sider

Do you have a sense yet of how much more costly the pilot deal could be if you have to go back and boost the pay rates and other adjustments to match the United deal?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

I'm looking at Devon. We're working on that right now. Look, one of the things I do know is that in our TA, there was significant quality of life and compensation improvements. The vast majority are very close to what United has supposedly in their TA. And while there may be some adjustments that would be required for wages, it's not inordinate amount. Devon, do you have any idea on that?

Devon E. May - *American Airlines Group Inc. - Executive VP & CFO*

Yes. We're working through the numbers right now. Obviously, the wages are close, but a couple of percent higher than what we have in our tentative agreement. And we're trying to get more detail on other items that we think might be material. But what we have with our tentative agreement is really significant improvements for our pilots.

And as Robert mentioned earlier, the wages is some we're focused on right now to see if we can work with the APA to get some done where we match what United's put forth.

Alison Sider

And I guess, Robert, you talked a little bit about this earlier this morning, but just curious if there's any kind of impact you're seeing from this crazy heat we're seeing in parts of the country, if that requires any operational changes or different ways of thinking about things for crew and for customers and how you're dealing with that?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Ali, and I have David Seymour here to help me. Look, the heat that we're facing this year in the country, I mean, these are records, and it is something that impacts certainly, the aircraft, any machinery, they're more (inaudible) and run harder and longer. And it's also really hard on our people. Fortunately, we have great experience in dealing with hot weather hubs, places like Phoenix and Miami and even DFW and Charlotte as well.

So we're employing all those practices that we put in place. We're just having to use them more often and longer throughout the year. I'll give you just a couple of examples of things that we've done on a precautionary basis just because of the trends that we've seen. We put a heck of lot more work into making sure that we're prepared for the summer on things like conditioned air at our jet bridges. So as soon as an aircraft pulls up to a gate, we want to make sure that we can get air to those aircraft to keep them as cool as possible.

Our APUs, those little engines that are able to power all the systems when the big engines are off. Those are things that are prone to break during times like right now, but we're seeing really good results because of the preventative work that our maintenance team has done. And you'll see us as well, whether it's making sure that we only board when aircraft are -- have air conditioning that is appropriate or out on the ramp with our team members, making sure that they get a break from the sun and the heat that there are things like ice carts and electrolyte drinks available to our team members, we're really taking this seriously, and we're going to have to as we go forward.

Operator

Our next question comes from the line of Mary Schlangenstein of Bloomberg News.

Mary Schlangenstein

I had just 2 quick questions. Vasu, on the LaGuardia slots, are you prohibited from leasing those slots to JetBlue for just their own use for their own flight? So do you have to take those slots back? You can't lease them to them under any circumstances. And my second question is on the pilot talks, are you reopening the whole contract to discussion? Or are you limiting it to changes in pay?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

So I'll handle the -- I can handle both. First off, in regard to anything that relates to slots or gates or routes or things like that. Look, we're going to figure that out over time. So I'll leave it at that. And then in regard to our pilots, as I mentioned, we're sitting down with our pilots. We have a real interest in making sure that they're taken care of. That's been how we viewed all discussions. And so we'll see how that goes. My hope is that we can get something done pretty quickly. And no matter what, over the long run, we're going to make sure that our pilots were taken care of.

Operator

Our next question comes from the line of Leslie Josephs of CNBC.

Leslie Josephs

Just on the pilot contract. I just want to make sure that I understand correctly, you are committing to matching the United rates. I just want to make sure we're clear on that. And then just a second question on buy-ups to premium cabins. We didn't hear a ton of that from you guys. And just kind of curious what you're seeing, especially for premium leisure and international, are you seeing higher paid loads in premium economy and then in business class.

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

I'll handle the first one, Leslie, and Vasu can handle the second one. Just, look, again, in regard to your question, we're working with the APA and our pilots. Our intent is to match the wages that we're aware of in the tentative agreement that United has signed.

Vasu Raja

Yes. And Leslie, we do -- we've noted it all through the recovery, but we've continued to see strength in premium cabin style fares. Our total premium seats across the system are up about 5% year-over-year. Our total premium revenues were up about 15% year-over-year. And notably, it's pretty consistent across all of our markets in London, for example. We've grown our premium seats about 20% or so. Our premium revenues are up over 25%. And that's at a time when so much of the industry is adding back into London.

But we are encouraged, and we're uniquely encouraged by the trajectory that we're on different from others. For the first time in our history, our unit revenue performance in Transatlantic will outperform any of our joint venture partners, both for the quarter and for the full year. So we do see that strength. It's complemented by our distribution strategies, and we see more opportunity ahead.

Leslie Josephs

And just one quick follow-up. When you get out of the summer season, are you seeing any kind of falloff in either fares or bookings with the TRASM coming down and then the inflation report showing that airfares are coming down in the U.S.

Vasu Raja

Nothing beyond historical seasonality, Leslie.

Operator

Our next question comes from the line of David Koenig of the Associated Press.

David Koenig

Robert, you've talked about matching the United deal, which APA had valued their previous TA at $8.3 billion, and this is going to add a couple of percentage points. Do you plan or do you need to raise fares to cover the contracts with the APA, the APFA or other contracts and still remain profitable, should people expect higher fares?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

David, thanks for the question. Look, over time, we're going to run a profitable business. So we have to offer a really compelling product offering to our customers. We're going to try to find ways to make sure that we can do that in a way that customers will benefit and ultimately, it will take more revenue to pay for higher cost (technical difficulty) going to do everything that we can to be as efficient as possible, take care of our team members, but also offer a very compelling and worthwhile product to our customers.

David Koenig

Okay. Any other revenues for revenue besides fares?

Vasu Raja

None beyond what we've already spoken about in the call.

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

David, we're really proud of our incredible network that we're flying reliably, and we've got an industry-leading rewards program. We're going to tap into those and make sure that our customers are really able to benefit from everything that we can do on that front.

Operator

Thank you. That concludes the Q&A portion of this call. I would now like to turn the conference back to Robert Isom for closing remarks. Sir?

Robert D. Isom - *American Airlines Group Inc. - CEO, President & Director*

Thank you, [Atif.] Thanks so much. And I'll just close out this way. Look, you can continue to hold us accountable for relentless focus on reliability, profitability and strengthening our balance sheet. And I'll just point to the second quarter results.

In terms of reliability, no one has been better than American Airlines over the last year. In terms of profitability, this second quarter beat by -- of all analyst's expectations is just proof that our commercial offerings are really registering with our customers. You run reliably, you produce profits, you can strengthen your balance sheet. This 2-notch upgrade from Fitch today is, again, indicative that we're doing the right things, and we would anticipate further strengthening on that front. All of it together, this outstanding second quarter for us is proof positive that our efforts are working. We're going to get back at it. Thank you very much.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
