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AAL.OQ - Q2 2024 American Airlines Group Inc Earnings Call

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OVERVIEW:

Company Summary

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Editor

PRESENTATION

Operator

Thank you for standing by, and welcome to American Airlines Group Second Quarter 2024 earnings conference call. (Operator Instructions) I would now like to hand the call over to Scott Long, VP of Investor Relations and Corporate Development. Please go ahead.

Scott Long - American Airlines Group Inc - Vice President, Investor Relations & Corporate Development

Thank you, Latif. Good morning, and welcome to the American Airlines Group Second Quarter 2024 earnings conference call. On the call with prepared remarks, we have our CEO Robert Isom; and our CFO, Devon May. In addition to our Vice Chair, Steve Johnson, we have a number of other senior executives in the room this morning for the Q&A session.

Robert will start the call with an overview of our performance, and Devon will follow with details on the second quarter in addition to outlining our operating plans and outlook going forward. After our prepared remarks, we'll open the call for analyst questions followed by questions from the media. To get on as many questions as possible, please limit yourself to one question and one follow-up.

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, 2024. In addition, we'll be discussing certain non-GAAP financial measures, 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 in the Investor Relations section of our website.

A webcast of this call will also be archived on our website. The information we are 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 Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Thanks, Scott, and good morning, everyone. This morning, American reported an adjusted pre-tax profit of \$1 billion for the second quarter, driven by record quarterly revenue of \$14.3 billion. We finished the quarter in line with our revised guidance with second quarter adjusted earnings per diluted share of \$1.9 despite the impact of significant weather events on our operation in May and June.

Before I get into more detail on our second quarter results and outlook, I want to first acknowledge that our current revenue performance is not where we wanted to be. In May, we made a sizable adjustment to our revenue and earnings expectations for the second quarter, driven by an imbalance in domestic supply and demand and our prior sales and distribution strategy. We know we can do better and we will rise to meet this challenge.

I'll begin with an update on those two key areas that are impacting our results. The softness in the domestic marketplace and our sales and distribution strategy. I'll also outline the clear and decisive actions we're taking, to course, correct.

First on the softer domestic revenue environment. In the second quarter, we saw the impact of too much industry supply in the domestic market, especially in regions of the country where we have larger operations. That excess capacity led to a higher level of discounting activity in the quarter than we anticipated.

As we said we would to address the domestic softness, we pulled down our planned capacity growth in the back half of the year. To better align our growth with demand expectations, we now plan to grow capacity by approximately 3.5% in the second half of the year.

Second, our sales and distribution strategy. In late May, I said our sales and distribution strategy was not working and we needed to make a change. We're taking actions that will improve our performance. But a reset will take some time and we will continue to feel the impact of our prior sales and distribution strategy on revenue and earnings through the remainder of this year, which is reflected in our updated full year guidance.

Let me outline the three key parts of our plan in leadership and organization and working with the travel agency community and in addressing the needs of our corporate customers.

With regard to our commercial organization, we immediately took action and change senior leadership, Steve, our Vice Chair, second in command and most seasoned and accomplished executive has taken charge of our commercial efforts, reorganized the team, completed a deep dive on issues and opportunities and laid out a recovery plan that we are executing on quickly.

We have also strengthened our revenue forecasting processes. Our near-term actions are concentrated on winning back customers and our share of revenue in agency and business channels. To that end in June, we reinstated fares and the distribution channel traditionally used by travel agencies and corporate managed travel programs.

Approximately \$14 billion of our annual revenue was booked through this system in 2023. This action ensures our product is available wherever customers want to buy it and removes the most objected to pain point of our previous distribution strategy.

Next, we engaged our large TMC partners to put in place new incentive-based agreements to restore our share in those channels. Those efforts have been well received. So we are having good conversations with companies, including MXGBT with which we have a long-standing relationship. We expect agreements with TMC soon, and we will then work to reengage the broader business and leisure agency community.

Additionally, we have eliminated plans to differentiate how customers earn miles based on where they book their travel, removing another significant obstacle impacting booking behaviour and business relationships. Our products need to be attractive and easy to engage with.

A significant piece of that is our AAdvantage business program, which replaced our previous unmanaged programs for business travellers. Those previous programs generated more than 2.5 billion in revenue in 2023, nearly 75% of which was booked through travel agencies.

With recent changes, we have now expanded the AAdvantage business program's benefits. So that participating companies will earn miles and travellers will earn loyalty points wherever they book, including through travel agencies. Several more improvements are underway to make the program easier for travel managers to use and we have established a dedicated help desk for AAdvantage business customers.

Our agency and corporate partners have made it clear. They want additional support as they do business with America. We have prioritized adding resources to our sales and sales support team and have made good progress already. In addition to the dedicated AAdvantage Business Desk, the team has hired new account managers for our corporate customers with more to come as we evaluate the appropriate level of staffing going forward.

In August, we will significantly increase resources dedicated to sales support to give customers the assistance they need. The agency and corporate customer response to these changes has been positive and we are starting to see share shift back to American.

Our partners are incredibly important to American, and we recognize we have a lot of relationships to repair. I have spoken with more than 30 of my counterparts at our largest corporate customers to get honest and candid feedback and these meetings and calls are occurring in parallel with our team's efforts to engage with customers at the travel manager level.

The feedback we've heard demonstrates that changes we have made are focused on the right areas and the agencies and corporate customers want to work with us as we continue to adjust our strategy. We will continue to listen and further refine our plans as needed. All of these actions and more to come our sign of our commitment to win back any customers we have lost.

We made a lot of progress from where we were in late May, but we still have a lot of work ahead of us. Success will ultimately be measured by improved revenue performance and earnings, but it will take time. In the near term, we will measure success by tracking our agency and corporate share performance and the adoption of AAdvantage business and by the feedback we are hearing from our agency partners and corporate customers.

I'm confident we'll regain the standing in the agency and corporate channel. And that, combined with our direct distribution strength, will put us back on track to producing revenues, it will meet and exceed our long-term financial targets.

Now I want to spend a few minutes discussing our second quarter revenue performance in more detail. Our unit revenue was down 5.6% year-over-year in the second quarter, in line with our revised guidance. Domestic pricing in the second quarter was down 6.4% year-over-year. Both short haul and long haul international presence performed in line with our initial expectations, with transatlantic unit revenue up year-over-year on 6.3% higher capacity.

Revenue from our large managed corporations was up approximately 3% year-over-year in the second quarter. This performance is not reflective of our fair share of corporate revenue and we are addressing it with the actions we're taking.

We have work to do to get our distribution strategy back on track. But as a global network carrier, we have access to premium and loyalty revenue streams that will continue to perform well. Demand for our premium product and overall engagement with the AAdvantage program remained strong.

In the second quarter, premium revenue or revenue from customer seated and first, Business Premium Economy and Maiden Cameron extra increased 9% year-over-year. Paid load factor in our premium cabins remains historically high and was up more than six points year-over-year with strength in both domestic and international.

With the planned refresh of existing aircraft and the expected deliveries of new aircraft, premium seating on American fleet is expected to grow by more than 20% by 2026. AAdvantage program membership continues to grow. Loyalty revenues were up approximately 8% year-over-year and AAdvantage members are responsible for 74% of premium cabin revenue. Total spending on our co-branded credit cards was up double digits year-over-year in the second quarter. Once again, highlighting the value of American's loyalty program.

Turning now to our operation. In the second quarter, the American Airlines team produced strong operational results despite some of the most difficult spring weather conditions we have ever faced and continued challenges with several of our suppliers.

Spring is always a good test for our summer preparedness and the weather we encountered in May and June tested us like never before. Just as we had ramped up to summer level capacity in mid-May, we were faced with severe weather that affected operations at multiple hubs and impacted our operational performance and the volatility continued into June.

By mid-June, we'd regained our operational momentum and it's clear our underlying resilience is strong, and we've made further strides in our ability to recover swiftly from these events. We've done an outstanding job of managing through unexpected weather disruptions, and our frontline team deserves tremendous credit for their efforts to get the airline back on track again and again.

Speaking of disruption disruptions, I'd be remiss if I didn't take a moment to applaud the entire American Airlines team for their work last week to quickly recover from the Global CrowdStrike outage that hit businesses and governments worldwide. By Friday evening, American's operation had recovered and we're set up for a strong weekend.

On Saturday, we ran on near 99% completion factor and were fully recovered. The best operational performance among US network carriers over the weekend. American recovers from irregular operations better than anyone in the industry and that was certainly the case following Friday's unprecedented disruption.

Finally, and importantly, we're pleased to have reached a tentative agreement on a new contract with our Association of Professional flight attendants. Upon ratification, this contract will provide immediate financial quality of life improvements for American flight attendants, one that we're proud of and one our flight attendants have earned.

I'll come back in a few minutes for some final thoughts, but now I'll turn it over to Devon to talk more about our second quarter financial results and the outlook for the third quarter and full year.

Devon May - American Airlines Group Inc - Chief Financial Officer

Thank you, Robert. Excluding net special items, we reported a second quarter net income of \$774 million, or adjusted earnings per diluted share of \$1.9. We produced record revenue of \$14.3 billion in the quarter, up 2% year-over-year. Unit revenue was down 5.6% year-over-year on 8% more capacity. Our adjusted EBITDA margin was 15.7%, and we produced an adjusted operating margin of 9.7%.

Our unit cost, excluding net special items and fuel was down 0.1% year-over-year. On our fleet, we now expect to take delivery of 20 new mainline aircraft this year, down slightly from our previous estimate of 22 aircraft. The remaining planned aircraft deliveries this year include 11 Boeing 737 MAX 8, 3787-9 and 3 Airbus A321neo.

We've taken delivery of six Embraer E1-75 this year and expect to take delivery of six more E1-75 through the remainder of the year. With these adjustments to our aircraft delivery schedule, we now expect our 2024 aircraft CapEx to be approximately \$2 billion and our total CapEx to be approximately \$2.9 billion. We continue to expect these moderate levels of CapEx to remain through the end of the decade, with aircraft CapEx plans to be between \$3 billion and \$3.5 billion per year from 2025 through 2030.

In the second quarter, we produced approximately \$850 million of free cash flow and ended the quarter with \$11.7 billion in total available liquidity. We reduced total debt by approximately \$680 million in the second quarter, and we have now reduced total debt by \$13 billion from peak levels in mid-2021. We remain on track to reduce total debt by \$15 billion from peak levels by the end of 2025.

Now I'd like to walk you through our outlook for the third quarter and provide an update on our full year guidance. In addition to commercial execution, our focus continues to be on delivering a reliable operation, maximizing profitability and reengineering our business to drive savings and greater productivity and a better experience for our customers and team members.

As we have stated in the past and shown with our recent capacity reductions, we will remain nimble in our planning to ensure our growth is in line with our expectations of demand.

As Robert mentioned, we lowered our planned capacity growth in the back half of the year and now plan to grow capacity by approximately 3% in the third quarter, with August up approximately 2% and September up less than 1% year-over-year.

With these adjustments, we expect to produce less capacity in the third quarter of this year than we did in the same period 2019. We expect third quarter travel to be down 2.5% to 4.5% and full year travel to be down 3% to 5% versus 2023.

Our work to reengineer the business is progressing well. We are ahead of plan and expect to deliver approximately \$400 million in cost savings in 2024. Additionally, we continue to find opportunities to improve working capital. By the end of this year, we now expect to have achieved more than \$300 million in incremental working capital improvements, which is in addition to the \$100 million we achieved in 2023.

Third quarter CASMx is expected to be up approximately 1% to 3% year-over-year. We expect our full year CASMx to be up approximately 1% to 3% consistent with our prior guidance despite lower planned capacity growth. Our current forecast for the third quarter assumes a fuel price of between \$2.55 and \$2.75 per gallon.

Based on our current demand assumptions and fuel price forecast, we expect to produce an adjusted operating margin of between 2% and 4% in the third quarter and approximately breakeven adjusted earnings per share. We now expect to deliver a full year operating margin of between 3.5% and 5.5%. This guidance is based on our current demand expectations and assumes a fuel price of between \$2.65 and \$2.75 per gallon.

At the midpoint of our full year guidance, we now anticipate producing adjusted earnings per diluted share of approximately \$1 and free cash flow of approximately \$500 million. These results are not good enough. Our team is focused on commercial execution and delivering results, and I'm confident we can close our relative margin gap with our peers and achieve our long-term financial targets.

Now I'll turn it back to Robert for closing remarks.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Thanks, Devon. Our airline is designed to deliver results. Results for our shareholders, results for our customers and results for our team members. We have not met our expectations this year, and our entire team is focused on working with urgency to get us back on track, improve results and deliver on our commitment that will drive value for our shareholders and all of our stakeholders.

As we take a step back, the foundation of our business remains strong and our priorities remain the same. Our operational reliability continues to perform at historically strong levels. Our fleet is the best among US network carriers and drives enormous value for the airline.

With this fleet, we have stable and moderate CapEx through the end of the decade. We've made great progress in strengthening our balance sheet and remain on track to reduce our total debt by \$15 billion by the end of next year.

Our network is well positioned and we are working to finalize our co-branded credit card negotiations. We're ahead of plan in reengineering our business to operate more efficiently and productively, and we're managing our costs better than anyone in the industry. We're committed to

delivering on a strategy that maximizes our revenue and profitability and importantly, when it makes it easy for customers to do business with American.

We remain committed to deliver margin expansion, free cash flow and continued debt reduction over the long term. When we return to the level of revenue production we know we can achieve and coupled that with our operational reliability and best-in-class cost management, we will unlock significant value.

Operator, you may now open the line for analyst questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Michael Linenberg, Deutsche Bank.

Michael John Linenberg - Deutsche Bank AG - Analyst

Oh, hi. Good morning, everybody. Hi Robert and Devon, appreciate you giving us the full year transit guides So we actually have third quarter and fourth quarter. And just based on that by inference I would suggest that fourth quarter is still going to be under pressure, in fact, it could be negative. And yet when I think about the decal and your own capacity growth and what we're seeing around in the industry.

As we look into that, fourth quarter. Is it that the corporate disruption or your strategy, your sales and distribution strategy and the impact that it's had on the corporates that it's going to take a lot longer or embedded in that? Are there other factors like maybe more moderate demand sluggishness, whether it's US or international, that revenue forecast has seen a bit anaemic in the fourth quarter. If you could drill down into that would be great.

Thanks. I have one more.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Hi Michael, I'll start. Look, the forecast, and we produce is based on what we see in the marketplace today. We all know that there's a supply and demand imbalance, and we're taking swift action to make sure that we are reducing our planned capacity growth in the back half of the year. But it's still a murky environment from that perspective.

And we'll have to see where the industry settles down a lot of our problem is caused by our sales and distribution strategy that we put in place in 2023. We think that it's had about three-quarters of \$1 billion impact in the first six months of the year. And we've more or less assume that is going to be what happens in the back half.

But I'll say this though it doesn't take into account what we're going to be doing to try to win back our share. We don't know how long it's going to be; it's going to take. You've heard about some of the things that we've done. We've seen a modest improvements in terms of capturing share in the indirect channel based on just making sure that we're fully available within the effect.

From a content perspective, we're renegotiating our agency contracts right now and getting new agreements in place. We're reaching out to our corporate. So our intent is certainly to do everything we can to get back on a better pace. But right now, we're building in what we see in the marketplace.

Michael John Linenberg - Deutsche Bank AG - Analyst

Okay, great. And just my second, just with respect to leadership, you talked about leadership changes on presumably Steve's move over to commercial is a temporary one. Have you identified someone or is there a search to actually bring on a Commercial Officer, a Chief Commercial Officer and are in your sales side of the business plans to not only rebuild it but bring back some of Mike and Alison Taylor make it, someone within a more senior position and a bigger operation. Just some comments on that. Thank you.

Thanks for taking my questions.

Devon May - American Airlines Group Inc - Chief Financial Officer

Hi, Mike. I'll just start with this. We know we have to get done and I've asked Steve to take over the commercial team and he's doing just that. As I said in my comments, he is our most seasoned and experienced and accomplished executive. His whole career has been dedicated to addressing and solving really complex problems. He knows our company. He knows the business really well and he knows our people. He's reorganized his team. He's done an immediate dive into what we needed to take it to take care of right away.

We're doing that. We're moving incredibly quickly and Steve's going to take care of this until we get the job done.

Operator

Thank you.

Scott Group, Wolfe Research.

Scott Group - Wolfe Research, LLC - Analyst

Hi, thanks. It's Scott. So I know you guys are slowing capacity growth, but we're still growing off of a base of a lot of growth in second half last year. So I guess, why aren't we being more aggressive in reducing capacity?

Should we potentially be shrinking capacity right now? And then I guess we're not so maybe can you talk a little about the capacity plans for 2025? And if I can, I just want to sort of marry that to some of the CapEx views, just given the current earnings run rate and implied sort of cash burn, I guess, can you more materially -- can we is there opportunities to sort of cut that CapEx that I think is set to minimum go up a bunch next year.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Scott, thanks for the questions. But just first off, in terms of capacity, again, reason for adjusting capacity supply and demand imbalance, and it's led to pricing weakness. From that perspective, we've taken action as quickly as we can and from that perspective, you'll see that our total growth in our total capacity in the third quarter is now planned to be actually a little bit less than we were in the third quarter of 2019. The capacity adjustments that we've made, Devon can help me with this. In August is we pulled down to 1% growth.

Devon May - American Airlines Group Inc - Chief Financial Officer

In July, capacity was effectively said as we went through an updated guidance in May but we now have August capacity grown by about 2% and September will be growing by less than 1%.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

And Scott, as we take a look at into the fourth quarter and then beyond, we're going to react to the marketplace and making sure that we're competitive. But at the same time, you're doing what's right for profitability. So as we take a look at into 2025, we're going to be very diligent in assessing and making sure that we're certainly not outgrowing demand.

Devon May - American Airlines Group Inc - Chief Financial Officer

Scott, just on your second question around CapEx and where we're at with cash, we still are expecting to produce free cash flow this year. Well modestly we expect around \$500 million of free cash flow in 2024. As we look out to next year, we do have a step-up in CapEx, but it's not that significant.

It's just one of the great things about our fleet and where we're at, we have pretty modest CapEx going forward. We've talked about CapEx being in that at \$3 billion to \$3.5 billion range for aircraft in 2025 through 2030. I expect 2025 is going to be at the low end of that range and possibly even slightly below that guidance.

Operator

Thank you.

Jamie Baker, JP Morgan Securities.

Jamie Nathaniel Baker - JPMorgan Chase & Co - Analyst

Hi , good morning, everybody. So in a perfect world for American. So let's just ignore aircraft constraints for the moment. If you can just snap your fingers, what do you think American's optimal domestic to international balance would be? I mean, it seems like part of the problem, at least from my perspective is that your oversize domestically, undersized internationally, perhaps you don't agree with that, but just wondering your thoughts in this regard.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Hey, Jamie, thanks for the question. Look, there's no perfect world. And in terms of snapping fingers, we all know that we're the product of years and years of building our network and our system. I really like where we are from a network perspective. One of the things everybody needs to be mindful of is that regional differences in terms of growth and profitability are going to happen every year and there's just differences in terms of international demand versus domestic.

When you take a look at our network and where we're strongest, it fits very well with where both population growth and economic demand is forecast now and long into the future. The basis for international (technical difficulty) our domestic network and our ability to fly into our partners' hubs and into secondary cities in Europe and Asia and South America, it's built on the strength of our North American network, and we're really pleased with what we've built over time.

Short haul international and MCLA, we're really pleased with what we've built in terms of our hub structure. So my answer to your question is I love the basis on which we can operate. And as we see where demand strength around the world is going and how it's going to change, we're going to build off (technical difficulty) put so much time and energy in over the years.

Jamie Nathaniel Baker - *JPMorgan Chase & Co - Analyst*

Okay. Thanks for that perspective. In second, as we think about AAdvantage, given some of the profit challenges, do you think that alters your hoped for improvements in loyalty returns?

You know, I'm just putting myself in, let's just say Citibank shoes, for example, if Delta and Amex returns are the gold standard for loyalty. I just have to wonder if Citi would take your profitability into consideration as you renegotiate. Is that a flawed assumption?

Robert Isom - *American Airlines Group Inc - President, Chief Executive Officer, Director*

I think it is a flawed assumption. Look at loyalty revenue has been one of the bright spots in terms of our revenue performance year-over-year. And I think Devon help me out the royalty revenues grew by 88% year-over-year. We think that we can do a lot better than and it's based on not only what I see in our loyalty program and how attractive it is to our customers, but also by our partners.

Citi is certainly at the forefront of that. They absolutely want to get involved in more and deeper ways. We're going to take AAdvantage of that and the opportunity for us, yes, it's actually making up some of the ground versus where other network peers are and have great comps. We're going to be doing and able to do that because I know that in terms of the negotiations that we're pursuing, that it's going to be a better deal in the long run and produce results that I think will be very positive.

Operator

Thank you.

Savanthi Syth, Raymond James.

Savanthi Syth - *Raymond James - Analyst*

Hi, good morning, everyone. Just kind of wondering on the on the cost side, the execution has been better and wondering how what's driving that. And as you kind of build back here, sales force. Do you see any changes there or do you expect to kind of continue outperforming on the cost side?

Devon May - *American Airlines Group Inc - Chief Financial Officer*

Well, we are really proud of our cost performance over the past several years. We have been industry leaders in our unit cost performance, and it's just been a focus across the board. It starts with a really strong operation, but we've been talking a lot about how we are reengineering the business for efficiency and leaning into technology to drive better productivity and a better experience for our team members and customers.

So we're continuing on that. I feel we're progressing really well. I do expect some amount of cost pressure as we rebuild the sales staff. There's going to be some cost pressure as commissions go up, but I think we're managing cost better than anybody. And as we get into 2025, we'll have the same focus that we've had for the past several years.

Robert Isom - *American Airlines Group Inc - President, Chief Executive Officer, Director*

Hi Savi, I'll just add to that. That's one of the things that gives me great pride in what the company has done, but also it's the basis on which we're building up and building back. We've managed costs better than any (technical difficulty) a name we've run the most reliable airline in terms of completion factor over the last year or so and as evidenced by what we were able to do with the CrowdStrike issue.

We've got a great fleet, low CapEx. As I mentioned earlier, we're going to be renegotiating our co-brand credit card relationships. And I do think that there's even further things that we're going to be -- able to do from a cost perspective.

We've got to focus on right now is regaining the share that we ceded from an agency and a corporate perspective when we get that back, which we will and you add that to the strength that we have in the other areas that I mentioned, we're going to get back on track margin expansion, free cash flow production and then continuous path to improving our balance sheet strength.

Savanthi Syth - *Raymond James - Analyst*

That's helpful. And if I might, on the capacity side, just can follow-up Scott's question there. What's your domestic capacity kind of growth run rate here versus international? Because I'm guessing with the fleet delays, is it still a lot more domestic capacity growth where you're seeing more of the pressure as well?

Devon May - *American Airlines Group Inc - Chief Financial Officer*

Hi sorry, but they are the domestic details year-over-year. We do have domestic capacity up in the third quarter by about 3.5%. It'll be probably closer to 3% as we look out to the fourth quarter as we sit here today. But as Robert mentioned earlier, fourth quarter schedules aren't finalized and we'll continue to adjust based on the demand environment that we're seeing.

Operator

Thank you.

Conor Cunningham, Melius Research.

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

Hi everyone, thank you. You mentioned that you're starting to win back some share from the -- on the business side. I'm just curious on how you're doing that. Is there a cost headwind associated with it? And just I'm just trying to understand the margin profile as it's kind of won back from others out there? Thank you.

Robert Isom - *American Airlines Group Inc - President, Chief Executive Officer, Director*

Hi Conor. I'll start with look the actions we've taken so far have been really straightforward, and that is making sure that Americans content and product is available to any channel that wants to access it catch on. And that's just that alone has resulted in us winning back our passenger share.

Now the next steps to that are then going to be making sure that we reestablish productive relationships with the travel management companies and agencies. We're doing that, and I believe that will unlock further share growth.

And then on top of that, as I mentioned in my comments, I've talked to dozens of corporations and after getting content available and then also making sure that we have appropriate relationships or agreements in place with travel management companies, the next is to make sure that we're doing everything we can to have the right agreements in place with our corporate customers and to support them in a way that they feel valued.

I know that we've started down that path and everything that we're doing is about winning back that share. That just be just be frank, we over-indexed on direct and we've got to find a way to get it to play in the richer pool of indirect revenue. And that starts with having content, having relationships, positive relationships with travel management companies and agencies and then supporting our corporate customers in ways that they feel value.

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

Okay, helpful. And then I get that you're making changes to distribution and your network orientation isn't one for one. But now in the past, you've talked about how you're pleased with the network product, the onboard experience. You mentioned that you plan on closing the margin gap.

I just struggle to see how that happens without a more wholesome look at the product and networking. The reason I ask is there continues to be an ongoing concern just around liquidity for you guys as its cash burn kind of continues to be where it is today. Thank you.

Robert Isom - *American Airlines Group Inc - President, Chief Executive Officer, Director*

Thanks, Conor. Look out, I'll start with this. Up until through 2023, we have been closing the margin gap with our top competitors. The one thing that we did differently than others in 2023, as we put in place a new sales and distribution strategy.

We've recognized that's not working and we're making immediate adjustments to that. I've sized it for you in terms of the impact, which is very -- which is large and that is I think it's had an impact of about \$750 million in the first six months of the year.

That is something that we know that we can reverse and get back on the track of where we had been, which was up until the first quarter of this year, seven consecutive quarters of profitability, really doing a nice job of hitting guidance and closing margin gap. That is something that's still on in front of us. Our product is our network is certainly well positioned.

Our product is as well. That said, just like the rest of the industry, there's a supply and demand imbalance. We're taking action. I think that's going to help considerably, but you'll see us get back on track as we capture our share to as I said before, margin expansion, free cash flow production and making sure that we have a solid balance sheet.

Devon ?

Devon May - *American Airlines Group Inc - Chief Financial Officer*

Yes, trying just on your question on where cash is and you mentioned cash burn. As we talked about in the script, we don't have cash burn this year. We're producing free cash flow. We ended the second quarter with over \$11 billion of liquidity. We have reduced total debt by \$13 billion from peak levels. Our net debt is lower today than it was at the end of 2019. So from a cash perspective, we feel we're in really good shape. We expect to continue to deliver as we go through 2025, and we expect to hit our 2025 target of total debt reduction of \$15 billion.

Operator

Thank you.

Tom Fitzgerald, TD Cowen.

Tom Fitzgerald - *TD Cowen - Analyst*

Hi, everyone. Thanks very much for the time. Could you talk about the PSP loans resetting to a much higher variable rate in the coming 18, 20 months? And just how you're thinking about we're balancing those needs.

Devon May - American Airlines Group Inc - Chief Financial Officer

Okay. Yes, sorry. For the PSC loans, they do reset as we're going forward. And I think they're so far plus 200. So still a pretty good rate for us, but we'll continue to watch the market. And if the marketplace allows for a refinancing at better rates, we'd look to do that. But for now, we see them remaining outstanding until maturity.

Tom Fitzgerald - TD Cowen - Analyst

Okay. Thank you very much.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Go head Tom.

Tom Fitzgerald - TD Cowen - Analyst

I switch to a follow up. So if you have a more to go there, Robert, I'm happy to pause.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

No, go ahead.

Tom Fitzgerald - TD Cowen - Analyst

Okay. I'm just curious on the network side, how you guys are thinking about the hub structure and whether you need to maybe pull back in any of the coastal gateway markets or on how you're thinking about the Fortress hubs like Charlotte or DFW and others talk about a self-one of your neighbouring Dallas expanding more in DFW. So was just curious how you're thinking about your network strategy overall. Thank you.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Our network was very pleased with our positions in both the DFW and Charlotte. You'll see that the majority of our growth this past year has been in those hubs. We really look forward to reestablishing as we are able to as we're bringing our regional network fully back up to speed. We're very much looking forward to filling out our presence in both Philadelphia and Chicago as well.

I like what I see in DCA Reagan National and how that is coming back. And again, while there's been pressure in short-haul, Latin, Miami, and Phoenix have all done fairly well for us as well. So in regard to our system, we're making sure that we're flying where we can produce the greatest level of profitability and one of the things that I'll just underscore again is that business traffic is something that travels throughout the country, throughout the world.

We're pleased with our network to serve. I think almost 90% of the places that you might want to go in the world. We've got a network that is going to appeal. And right now we've got to go back and win back our business here. So Tom, thanks for the question. But what I wanted to say though, was I want to just take a quick moment to recognize your predecessor, Helene Becker for her accomplished career and valuable work and contributions to our industry over the past 40 years.

And I'm pleased to say that I've known Helen for a lot of those 40 years. So from all of us at American Hallein, we'll miss working with you. We wish you the very best in your new advisory role and Tom best of luck to you as well.

Thank you.

Operator

Thank you.

Duane Pfennigwerth, Evercore ISI.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities - Analyst*

H, thanks. Just on the I guess, the mismatch of domestic supply demand. If we could track back to earlier this year, maybe to Investor Day, what was the thinking on 9% domestic growth in 2Q? It feels like at any point of that would have been really out of sync with the GDP, even stable GDP and trying to better understand what the company was solving for.

Was it chasm goals or share goals. And with the change in leadership, do you now have an opportunity to put more of a weighting on what the economy may actually be doing from a network planning perspective ?

Robert Isom - *American Airlines Group Inc - President, Chief Executive Officer, Director*

Duane thanks. I'll start and Devon certainly can fill in the blanks. Look, we anticipated a obviously a more a stronger more robust demand environment, plain and simple. There was a tremendous growth in 2023. And as we entered into 2024, we simply anticipated that demand would perform and allow pricing to perform a lot better than it did.

As we've taken a look from that time, we certainly understand that weren't in a marketplace that couldn't absorb all that capacity. And so as we've said we're making those immediate adjustments, but you'll see us be very, very conscious as we go forward. But I'm going to underscore again, the biggest issue that we've had in terms of disappointment was our misstep and our sales and distribution strategy that would have accounted for a considerable amount of additional revenue. And it's something that we're going to make sure that we gain back.

Duane Thomas Pfennigwerth - *Evercore ISI Institutional Equities - Analyst*

Okay. I mean maybe just to come at it from a different perspective. The margins are what they are over the last 12 months as you analyse your own network even with this distribution change. Do you have similar margins hiding somewhere in your network or are there portions of your network where you say geez, we're at least as profitable, maybe more profitable in portions of our network.

And if so, why isn't the answer to cut more unprofitable capacity?

Devon May - *American Airlines Group Inc - Chief Financial Officer*

Hi Duane. I just maybe I will start by following up on your first question as well that the first half capacity was at least in part the rebuild still of our 2019 capacity. We've added less capacity back anyone else, we had some hubs that were still are below their historical capacity levels that slowed in the second half as we've added capacity.

On your second question around unprofitable components of the network. This is something that we are always looking as to move capacity into our most profitable parts of the network and to improve on areas of the network that are softer, but we have a fantastic hub network. There's always going to be best performers and performers at the other end. We think all of our hubs can be solidly profitable. And while there are some laggards today, we have a revenue team that has a strategy to improve on.

Operator

Thank you.

Andrew Didora, Bank of America.

Andrew George Didora - BofA Securities - Analyst

Hi, good morning, everyone. I guess touching on demand, given what transpired with the promo environment over the last few months, you've come your thoughts around the demand backdrop changed at all? And are you seeing any areas of demand softness? Or are there any geographies where maybe the promotional environment did not stimulate demand the way that you would have thought?

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

So now I'll start Andrew. So look from a regional perspective, a lot of the capacity that has come in to the industry has been in places that we've been traditionally strong. But I also expect that as we take a look going forward, that the adjustments to capacity will likewise be in places that potentially benefit us as well.

But as you know, we've seen significant pressure in parts of our network that have been profitable and continue to be quite profitable, but just less so things like our short-haul international MCLA. We've seen some pressure in other places, a lot of it again due to the fact that we've missed out on a pool of premium revenue and business traffic that we're going to win back. As I take a look overall, I don't see a lot of variability in terms of impact throughout our system other than what I've noted.

Andrew George Didora - BofA Securities - Analyst

Okay, thank you for that. And then, Devon, just a housekeeping question. Can you remind us is the new flight attendants deal in your guide and have you been accruing for that over the first half of '24?

Devon May - American Airlines Group Inc - Chief Financial Officer

There has not been accrual for it through the first half of 2024. It is in the guide starting in September when we assume ratification, and then it's in our fourth quarter outlook as well.

Operator

Thank you.

Sheila Kahyaoglu, Jefferies.

Kylie Cohu - Jefferies LLC - Analyst

Hi, this is Kylie Cohu on for Sheila incest. I wanted to ask the cash picture question a little differently as free cash flow is down \$1 billion and \$1.5 billion on the year. And if we look into '25, the guide was greater than \$2 billion, which is presumably handicapped and was on like for like basis, the amount of that was first to come out next year. So just wondering how you bridge given you reiterated the sub \$35 billion in the out years here?

Devon May - American Airlines Group Inc - Chief Financial Officer

Sorry, a little bit of trouble hearing the question, but on cash and cash outlook for 2025. Yes, we had been projecting greater than \$2 billion of free cash flow in 2025. We're not updating our '25 outlook right now. Obviously, we expect to perform better on top line, but we'll give guidance as we get into next year.

As it relates to our total debt reduction expectations, we were tracking ahead of our \$15 billion plan before. We have a lot of liquidity. We have the ability to go ahead and raise additional debt if we need to. But right now, the expectation in 2025 is that we will produce free cash flow, we will meet our \$15 billion debt reduction target, and we'll have solid liquidity as we get through the year.

Kylie CoHu - Jefferies LLC - Analyst

Okay, thanks. And then just my follow-up is on the commercial strategy, given your large Texas peer today announced some changes around what will be more premium like [exceeding] So maybe just initial impressions as it relates to the commercial strategy and the share changes that you guys are hoping to see.

Thank you.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Well, I'll just start with look premium business is important to us. And as I mentioned, it's one of the bright spots that we've seen year-over-year. And we anticipate that strength is going to continue. We're going to continue. We're going to invest in it. We're going to invest in it with real product, real hard product. And it's not something that we have to talk about. It's something that we have and that will continue to grow in our fleet.

So not only do we have the most premium seats of any carrier in the marketplace today, but we anticipate growing those by 20% as we go out into 2026 headlining that is new 321 XLR that will come in 2025. There will be a great product for things like short-haul Europe as well as augmenting our transcontinental fleet, our operations.

We're going to be redoing our 777-300 that will add premium seating, new flagship suites. And then add to that, the deliveries of 7879 as well with the flagship suites. So overall, I feel really good about what we can do ?

Now to say as well. Look, we've been operating a premium network, a worldwide network for decades on all the way back to our early days. We feel really confident about our ability to operate against any type of competition and I really like where our fleet, our product, and our ability to service that stands right now.

Operator

Thank you.

Stephen Trent, Citi.

Stephen Trent - Citigroup Inc. - Analyst

Good morning, everybody, and thanks very much for taking my question. The first, if I may. I know in sort of a follow-up to Jamie's earlier question, I can appreciate that you guys sort of hit the reset button on your co-branded card agreement and from a high level when we think about the time line and when you can finalize the agreement to use a baseball analogy, are we in kind of the second inning or the fifth inning ?

Just would love your color on that, if I may, please.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Steve ?

Stephen Johnson - American Airlines Group Inc - Executive Vice President

Sure. Thanks for the question . We've been in discussions with our partners about our next co-brand arrangement for a while now maybe the fifth inning is probably a pretty good analogy, but long enough to know that we and they are really enthusiastic about what we could do next. And so we're really excited about getting to the eighth and the ninth inning and getting it wrapped up.

Stephen Trent - Citigroup Inc. - Analyst

Okay. I appreciate that. And also just kind of a follow up. We had, of course, Friday, that global network outage and what have you where you guys didn't seem to be much impacted at all. And I'm curious if you might be able to give a little color on what you guys are doing technologically and that perhaps lead you to avoid the issue?

Or was it something to it? Is you just have a different supplier? Just would just love to understand Thank you.

Robert Isom - American Airlines Group Inc - President, Chief Executive Officer, Director

Thanks, Stephen. Yes, I'll hand it off to our Chief Operating Officer, David Seymour. But I'll just say this we're really super proud of our ability to really react to any type of disruption. This was notable. And I think it just shows how strong we are in terms of our operating prowess. David?

David Seymour - American Airlines Group Inc - Chief Operating Officer, Executive Vice President

Yes. No, thanks for the question. And the like Robert talked about really proud of what the team did, but just like other airlines and businesses worldwide that were impacted by CrowdStrike. Many of operating systems did beat or were taken offline. But within an hour of that outage, we assembled the right operating teams and IT experts to develop and execute a plan to get our systems back online and the aircraft moving again.

And that allowed us to return to normal operations by the end of Friday. They are key differentiators really become the hallmark of operation and net a swift recovery from any significant disruption that the airline feels. So Robert talked about, we see a lot of weather, and you've seen us focus on that and lead the industry in recovery for the last several years, and we're going to continue to do that.

Editor

This concludes the analyst portion of this call.

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