American Airlines Group, Inc. (NASDAQ:AAL) Q2 2017 Earnings Call July 28, 2017 8:30 AM ET

Executives

Daniel E. Cravens - American Airlines Group, Inc.

William Douglas Parker - American Airlines Group, Inc.

Derek J. Kerr - American Airlines Group, Inc.

Robert D. Isom - American Airlines Group, Inc.

Donald B. Casey - American Airlines, Inc.

Maya Leibman - American Airlines Group, Inc.

Stephen L. Johnson - American Airlines Group, Inc.

Analysts

Jamie N. Baker - JPMorgan Securities LLC

Darryl Genovesi - UBS Securities LLC

Hunter K. Keay - Wolfe Research LLC

Andrew G. Didora - Bank of America Merrill Lynch

Duane Pfennigwerth - Evercore ISI

Jack Atkins - Stephens, Inc.

Savanthi N. Syth - Raymond James & Associates, Inc.

Helane Becker - Cowen and Company, LLC

Brandon Oglenski - Barclays Capital, Inc.

Joseph DeNardi - Stifel, Nicolaus & Co., Inc.

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Kevin Crissey - Citigroup Global Markets, Inc.

Andrea Ahles - Fort Worth Star-Telegram

Mary Schlangenstein - Bloomberg News

Conor Shine - The Dallas Morning News, Inc.

Susan Carey - The Wall Street Journal, Inc.

David Koenig - The Associated Press

Operator

Good morning, and welcome to the American Airlines Group Second Quarter 2017 Earnings Call. Today's conference is being recorded. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session.

And now I'd like to turn the conference over to your moderator, Managing Director of Investor Relations Mr. Dan Cravens. Please go ahead, sir.

Daniel E. Cravens - American Airlines Group, Inc.

Thanks, Alan, and good morning, everyone. Welcome to the American Airlines second quarter 2017 earnings conference call. Joining us on the call this morning is Doug Parker, our Chairman and CEO; Robert Isom, President; and Derek Kerr, our Chief Financial Officer. Also in the room we have, for Q&A session, Maya Leibman, our Chief Information Officer; Stephen Johnson, our EVP of Corporate Affairs; and Don Casey, our Senior VP of Revenue Management.

We are going to start the call with Doug and he will provide an overview of our second quarter 2017 financial results. Derek will then walk us through the details on the quarter and provide additional information on our guidance for the remainder of the year. Robert will then follow with commentary on the operational performance and revenue environment. And after we hear from those comments, we'll open the call for analyst questions and lastly questions from the media.

Before we begin, we must state that today's call does contain forward-looking statements including statements concerning future revenues and costs, forecasts of capacity, traffic, load factor, fleet plans and fuel prices. These statements represent our predictions and expectations as to future events, but there are numerous risks and uncertainties could cause actual results to differ from those projected. Information about some of these risk and uncertainties can be found in our earnings press release issued this morning and our Form 10-Q for the quarter ended June 30, 2017.

In addition, we'll be discussing certain non-GAAP financial measures this morning, such as net profit and CASM excluding unusual items. A reconciliation to those numbers to the GAAP financial measures is included in the earnings release and that can be found on our website at AA.com. A webcast of this call will also be archived on our website. The information that we're giving you on the call is as of today's date, and we undertake no under obligation to update the information subsequently.

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

William Douglas Parker - American Airlines Group, Inc.

Thanks, Dan. Thanks, everyone, for being on the line. This morning, we reported pre-tax earnings, excluding special items, of $1.5 billion and a pre-tax margin of 13.5%. Our earnings per share, excluding special items, were $1.92, which is up 8.5% versus 2016. We're particularly pleased with the revenue performance in the quarter. Our unit revenues increased 5.7%, which is evidence that the long-term investments we're making at American, in our product and in our team are working.

In the second quarter, we continued the most aggressive fleet modernization program in commercial aviation history. As we took delivery of 20 new aircraft to replace older aircraft in the fleet, we expanded our Basic Economy and Premium Economy products allowing us to offer more choices to our customers. And we're introducing new technologies to make it even easier for our customers to fly American, like proactive bag notification and auto re-accommodation tools.

These long-term product investments are examples of how we're working to validate the trust that's placed in us by customers when they choose American and by all of you when you invest in American.

We believe that building this trust starts first with our own team. We need an engaged and enthusiastic team if we want to be the best airline in the world. Early in the quarter, we gave unprecedented mid-contract increases in base pay to our pilots and flight attendants. And we continue to make other significant investments in areas such as customer service, training and team member empowerment. And we are working hard to finalize a joint contract with our ramp and mechanic team members.

We're running American for the long haul. And we're extremely bullish about the future prospects for our team members, our customers and our investors. Today's results provide validation we're on the right course and we are even more excited about what lies ahead.

So, we want to thank and congratulate our 120,000 team members who are the ones responsible for these strong results and the key to our future.

Derek is going to give you more color on the financials, and then Robert will tell you more about the great work our team is doing, and also about some of the exciting revenue opportunities we have ahead of us. Derek?

Derek J. Kerr - American Airlines Group, Inc.

Thanks, Doug, and good morning, everybody. I'd also like to thank more than 120,000 team members for everything they do each and every day. As a result of the outstanding job they do looking after our customers, we had another very successful quarter. As Doug mentioned, we filed our earnings press release and 10-Q this morning. In that release, our second quarter 2017 GAAP net profit was $803 million or $1.63 per diluted share. This compares to our second quarter 2016 GAAP net profit of $950 million or $1.68 per diluted share. Excluding special items, we reported a net profit of $944 million in the second quarter of 2017 versus our third quarter 2016 net profit of $1 billion.

Our diluted earnings per share, excluding special items, was $1.92 per share, up 8.5% year-over-year versus $1.77 per diluted share in the second quarter 2016. This growth reflects the impact of our share repurchase program, which resulted in a 12.9% year-over-year reduction in our weighted average diluted share count. Our GAAP second quarter 2017 pre-tax profit was $1.3 billion. Excluding net special items, our second quarter pre-tax profit was $1.5 billion, resulting in a pre-tax margin of 13.5%.

Turning to revenue, our total second quarter operating revenues were up 7.2% year-over-year to $11.1 billion. Passenger revenues were $9.6 billion, up 6.5% on yield improvement of 4.3%. Cargo revenues were up 13.1% to $196 million due primarily to higher volume. Other operating revenues were $1.3 billion, up 11.1% year-over-year, due primarily to revenues associated with our new co-branded credit card agreements that we signed in the third quarter of 2016. Robert will give more detail on our revenue performance during his remarks.

Total GAAP operating expenses for the second quarter of 2017 were $9.6 billion, up 11.1% versus the same period last year. This increase was due primarily to a 12.5% or $333 million increase in salaries, wages and benefits as a result of the mid-contract pay increases that Doug talked about, as well as rate increases for our ramp and mechanic team members which became effective in the middle of the third quarter of last year. Higher year-over-year fuel costs also contributed to this increase.

The second quarter CASM, cost per ASM, was $0.1334, up 9.6% year-over-year. Excluding fuel and special items, our consolidated CASM was $0.1049, up 6.8% year-over-year, due primarily to the salary and benefit increases, selling expenses due to higher revenues and aircraft-related depreciation expense. We ended the quarter with approximately $9.3 billion in total available liquidity, comprised of cash and investments of $6.9 billion and $2.4 billion in undrawn revolver capacity. The company also had a restricted cash position of $554 million. In July, our restricted cash was reduced to $490 million due to a reduction in our workers' compensation collateral requirements.

During the quarter, our treasury team raised $645 million in proceeds to finance 11 aircraft through private mortgages and sale-leaseback transactions. We also completed repricing on our $735 million facility secured by our London Heathrow franchise at a rate of LIBOR plus 200 basis points. In April, the company made a $279 million contribution to its pension plans, which was $254 million in excess of the $25 million required cash contribution in 2017. And, as a result, all of our pension plans continue to be fully funded under the Airline Relief Act.

In the second quarter of 2017, the company returned $500 million to its shareholders including quarterly dividend payments totaling $50 million and repurchase of $450 million of common stock, or 10 million shares. Our share count has dropped by 35% from 756 million at merger close in December 2013 to 488 million shares as of June 30.

In addition to our earnings release, we also filed our investor update this morning. Consistent with our previous guidance, in the third quarter of 2017, we expect our system ASM growth to be up approximately 2.7%. For the full year, we continue to expect consolidated system capacity to be up approximately 1.5%, driven by gauge up approximately 2.5% and stage length up approximately 1%, offset by 2% fewer departures.

We expect domestic consolidated capacity to be approximately flat year-over-year and international capacity to be up approximately 4%, primarily due to the continuing impact of the 777-200 retrofit program and the year-over-year impact of new Pacific markets that were added in 2016. We continue to expect the rate of CASM growth to decelerate throughout the remainder of the year. We expect our third quarter consolidated CASM, excluding fuel and special items, to be up approximately 4.5%, with mainline up approximately 5% and regional up approximately 2%. Our fourth quarter consolidated CASM expected to be up approximately 3%.

We are forecasting fuel prices to be up approximately 8% in the third quarter, based on the forward curve as of July 24, 2017. On a consolidated basis, we expect to pay between $1.57 and $1.62 per gallon which is slightly higher than our previous guidance. Using the midpoint of guidance we provided, we expect our third-quarter 2017 pre-tax margin excluding special items to be between 10% and 12%.

Our annual CapEx assumptions remain unchanged as we continue with our fleet renewal program, for the full year, we expect gross aircraft CapEx to total $4.1 billion, which includes the delivery of 57 mainline aircraft and 16 regional aircraft. In addition, we expect to invest $1.6 billion in non-aircraft CapEx for integration work and projects to improve our product and operations. Notable product investments completed in the quarter include new Admirals Clubs opening in Houston and Toronto, a major refurbishment of our JFK lounge and the induction of our last 777-200 for retrofit. We now will have lie-flat seats on all 777 fleet.

In conclusion, our team produced outstanding results in the second quarter and we look forward to continuing in this trend. This is a busy time of the year for our more than 120,000 team members and I would like to thank them once again for all they do to continue the success of American Airlines.

With that, I will turn it over to Robert.

Robert D. Isom - American Airlines Group, Inc.

Thanks, Derek. Good morning, everyone, and thanks for joining us. I'd also like to begin my remarks by thanking our 120,000 team members for the strong second quarter results. Without them, none of this would have been possible.

Over the past several earnings calls, we have talked a lot about the many commercial and operational initiatives to improve the overall experience at American, and it's rewarding to see many of these projects come to fruition as they move from planning phase to implementation. We successfully launched Basic Economy and our new Premium Economy cabin is also performing well. We also continue to make important long-term investments in things like customer service training, facilities improvements for both our employees and customers, and technology investments to improve the overall customer experience. In addition, we just launched phase 1 of our dynamic re-accommodation and proactive bag notification self-service applications. And those will be followed by other customer self-service tools that will provide improved capabilities for our customers.

Airport experience is also becoming more customer-centric with our new flagship experiences, as well as new and refreshed Admirals Clubs across the system. The first flagship dining (sic) [Flagship First Dining] location debuted at JFK on May 25 generating significant media interest and praise from the traveling community. American is leading the way in premium travel experience, and the great news is that there's more to come as we expand our updated flagship lounges and new Flagship First Dining experience to other key international gateways over the next 18 months. All of these investments are beginning to bear fruit and we're very excited about the opportunities ahead.

Our operational performance continues to gain momentum as we make progress relative to our domestic peers in each of the core operating metrics. One notable area where we continue to close the competitive gap is in our mishandled baggage, MBR performance which improved 17.4% year-over-year based on DOT-reported data. The extraordinary effort of our frontline team members to drive this sustained improvement is remarkable and it's encouraging to see investments in new technology, operation centers and new ground service equipment producing intended results.

We expanded our new Basic Economy product into 78 markets in the U.S. and Canada. The early results continue to be in line with our expectations with approximately half of the customers given an option to buy up to the Main Cabin, choosing to do so. We expect to roll out Basic Economy across our domestic network by the end of September. In addition, we're very pleased with the customer adoption of our new Premium Economy product, which has an average upsell rate of more than $400. These seats are now being installed on our 777-200 aircraft, and we expect to have most of our other widebody aircraft retrofitted with this highly differentiated seating choice for international customers by the end of 2018.

Turning to revenue, the overall environment remains robust and we are pleased with our performance in the second quarter. Our second quarter consolidated PRASM was up 5% and our second quarter TRASM was up 5.7%. Our significant investments in our people, product, and new corporate sales initiatives are paying off, and when coupled with our new revenue management tools, changes to our AAdvantage program, and our new mobile platform, the results have been impressive.

In domestic, our consolidated PRASM was up 5.7%. We saw strength across the board with Philadelphia and Miami leading the way with double digit increases. We continue to implement a number of revenue management initiatives for the Premium cabin and these are proving to be very effective. Our sales initiatives with our high-value channels are also gaining momentum as we continued to see strong performance with gains in corporate share, share gap and average ticket values.

Our Latin America performance, overall, was very strong with PRASM up 15.1%. Positive Latin PRASM was driven by a strong performance in all entities, an improved trend from the first quarter of 2017 where only South America had positive year-over-year PRASM performance. We expect positive Latin year-over-year PRASM performance for the remainder of 2017. Atlantic PRASM was flat year-over-year, but more than 5 percentage point improvement from the first quarter's year-over-year performance. Premium cabin pricing and yield management initiatives, improved share performance with travel management companies and easing comps from past year events will continue to contribute to 2017 year-over-year PRASM performance.

The UK is showing the largest PRASM improvement on a year-over-year basis due to improved Premium cabin performance. However, the overall environment remains challenged as low-priced carriers grow substantially resulting in a weaker pricing environment for coach travel. Across the Pacific, PRASM was positive for the second quarter, a sign that we are turning the corner on our capacity buildout for the Pacific. Both Japan and Australasia had strong year-over-year performance. Second-quarter cargo revenue improved 13.1% year-over-year on strong volume growth, continuing a trend we've seen since the latter half of 2016.

As we look forward to the third quarter, we do face difficult year-over-year comparisons that uniquely impact American. In the third quarter 2016, we benefited from competitive pricing actions, IT disruptions at one of our competitors and the Olympics. That said, we still expect positive unit growth in the third quarter. Regionally, our domestic PRASM is expected to be positive for the quarter in spite of some unique events that benefited last year. We think Latin America will again be our best-performing entity with performance in line with the first quarter. The Atlantic is expected to be flat and the Pacific in line with the second quarter.

Looking forward, we continue to be excited about our operational commercial investments and the value that we expect them to create. While our year-over-year comparisons do get more challenging as we lap the impact of our new credit card deal, the start of a stronger revenue environment in South America and some unique events last year, we expect our third quarter TRASM to be up approximately 0.5% to 2.5% year-over-year. Although this is lower sequentially than second quarter, this has more to do with 2016 than any trend for 2017.

Our comps for the second quarter were comparatively easy while the comps for the third quarter were comparatively hard for the reasons I've stated. The best way to view this is to look at the year over two year comparisons. When viewed through this lens, the second quarter and third quarter unit revenue change is almost identical and thus, we feel very good about our second quarter revenue performance and similarly good about our third quarter performance. And we also expect that our fourth quarter unit revenue performance will be better than our third quarter estimate. While we have a lot of work left to do, we are encouraged by what we have achieved so far and we look forward to the future.

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

Question-and-Answer Session

Operator

Thank you, sir. And we will take our first question from Jamie Baker with JPMorgan.

Jamie N. Baker - JPMorgan Securities LLC

Hey. Good morning, everybody. Doug, given your two-year capacity view as well as your view on just sort of technology in general, by the end of 2018, do you expect to have greater, fewer or the same number of employees as today?

William Douglas Parker - American Airlines Group, Inc.

I don't know, Jamie. I think we will be growing over that time. So I would expect we would have more people, but again, we'll see as we move forward and it's not something we – that's not a number we project.

Jamie N. Baker - JPMorgan Securities LLC

Okay. Also, can you tell us what percentage of the fourth quarter revenue is already on the books and what gives you the confidence in the fourth quarter RASM guide that you've delivered exceeding the growth rate of the third quarter and then it implies a rate of sequential improvement that's – I think it's better than anything you've witnessed since the close of the merger. So just wondering what the contributing factors are to the confidence there.

William Douglas Parker - American Airlines Group, Inc.

There's not much on the books, as you know, for the fourth quarter. It's more of what we see on a year-over-year basis versus 2016. (20:48) the third quarter is particularly a difficult comp, and the fourth quarter is less difficult. So if things stay the same, we expect we will see more improvement in the fourth quarter than we expect to see in the third quarter.

Operator

And we will take our next question from Darryl Genovesi with UBS.

Darryl Genovesi - UBS Securities LLC

Hi, guys. Thanks for the time. Doug or Robert, you guys have guided to a $1 billion potential benefit from cabin segmentation. I believe that was a number that Scott used to talk about. Do you still think that's a good number? And can you give us a sense of how much of that you might expect to come through in 2018?

Robert D. Isom - American Airlines Group, Inc.

We do think it's a solid number, and we're making great progress. As I said, Basic Economy is going to be rolled out throughout our domestic system by September, and our Premium Economy product is really dependent on how fast we retrofit our fleets. We should have that done by the end of 2018, and as we look past 2018 that should be in our numbers.

Darryl Genovesi - UBS Securities LLC

Okay.

Derek J. Kerr - American Airlines Group, Inc.

Yeah. This is Derek. I would – yeah, go ahead.

Darryl Genovesi - UBS Securities LLC

I'm sorry. Go ahead, Derek.

Derek J. Kerr - American Airlines Group, Inc.

No, I was going to say that the big piece of that is Basic Economy, and as Robert said, we'll have that all rolled out by the end of the year. So that should be all reflected in the 2018 numbers. Premium is the one that's going to take a little bit longer to be put in as we change the aircraft over.

Darryl Genovesi - UBS Securities LLC

Okay. And I guess United initially rolled out its Basic Economy product all the way up and down the fare ladder while I think Delta's was only at the bottom three rungs, and as I understand it your Basic Economy product looks more like Delta's than it does United's. If the primary objective of Basic Economy is to segment the market in such a way as to compete with the ultra-low-cost carriers without diluting the Premium fare from the late booking business traveler, then don't you need to offer Basic Economy all the way up to zero-day APE (22:58)? And assuming that's correct, does your Basic Economy product as you've structured it today prevent you from being able to do that?

Donald B. Casey - American Airlines, Inc.

Okay, this is Don Casey. When we roll out our entire product, you'll see exactly how we think the appropriate way to structure the products, so we're not going to disclose exactly how we're going to implement it. So I think it's a bit too soon to judge exactly what our plan is.

Darryl Genovesi - UBS Securities LLC

Okay. All right. Thanks, Don.

Operator

And we will take our next question from Hunter Keay with Wolfe Research.

William Douglas Parker - American Airlines Group, Inc.

Hey, Hunter.

Hunter K. Keay - Wolfe Research LLC

Hey. Good morning, Doug. I want to follow up on Jamie's second question because I think it's important, and I would kind of appreciate a little more thorough answer. I think the market would, too. On the 4Q commentary, if you don't want to give a number in terms of percentage bookings that's fine, but I think we should really get a sense for how you feel so comfortable about that. I think there's a lot of sloppiness and volatility in the close-in pricing which you alluded to. I just don't want this to become an overhang on the stock for the next five months, so like how can we be sure that you feel good about that hitting that number? I would imagine that you see like a pretty substantial gap between 4Q and 3Q to even put that out there. So what gives you the confidence, just one more time, to say that that's going to be better?

William Douglas Parker - American Airlines Group, Inc.

Same thing again. People don't book that far in advance, as you guys all know. So I don't know. Don, what do we have – percentage bookings on the...

Donald B. Casey - American Airlines, Inc.

14%.

William Douglas Parker - American Airlines Group, Inc.

About 15% bookings. So that 15%, for what it's worth, gives us some confidence, but it's only 15%. So that is not the source of the confidence. The point we're trying to make is our third quarter comp was particularly hard. Our fourth quarter comp looks less hard. Based on what we're seeing today, if the demand environment stays where it is today, we expect the fourth quarter increase will be greater than the third quarter. It's maybe about 16% to 17%. It's about 17%, staying where it is.

Hunter K. Keay - Wolfe Research LLC

Okay. All right. Thanks. And then on distribution, you had the distribution summit last month, I guess it was, can you talk about for a second what kind of feedback you've gotten from the TMCs around the direct connect concept since that conference, and how much of that is driving your expectation of corporate share gains? And can you help people understand what you're trying to do that's different than the industry in terms of sort of tailoring I guess specific products to specific corporations? And how you bank on that driving share gains? Thanks.

Donald B. Casey - American Airlines, Inc.

This is Don, again. First of all, our NDC strategy is a long-term strategy, right. It's not a short-term strategy. And so we don't really expect anything we are doing right now in NDC to have any impact on the corporate share performance. Having said that, we're getting a lot of momentum in corporate share performance for all the other things that we're doing. Our focus in our NDC initiative is to provide kind of tailored unbundled products to corporations that are going to be integrated into the booking systems that they use to manage travel, and that's going to be a value-added proposition to our corporate customers. But it's a long-term strategy, not a short-term strategy.

Hunter K. Keay - Wolfe Research LLC

Okay, Don. Thanks.

Operator

And we will take our next question from Andrew Didora with Bank of America.

Andrew G. Didora - Bank of America Merrill Lynch

Hi. Good morning, everyone. Derek, I know you've put out a goal of, I think, some 2% CASMex growth in 2018 and beyond. How do you think about your pre-tax margins in that context, assuming sort of the historical correlation of fuel with fares? Do you think you could ever get back to a level somewhere in between 2015 and 2016 pre-tax margins or is that sort of too aggressive right now?

Derek J. Kerr - American Airlines Group, Inc.

No. I mean, as you said, it depends on where fuel goes and where things are, but I think in an environment where we are at today, I think we can have margins that are above where we are at in 2017. CASM growth stays in the 2% range. We have a lot of initiatives that we've talked about that signal to us on the revenue side where we would have revenue growth higher than that that would produce margins that are comparable to those times in 2015-2016 timeframe. So, I think the margin growth is there over the next few years, and we've talked about our $5 billion number and we believe that that's where we can be from a pre-tax income perspective, up and down – ranged around $5 billion over the last few years, so we're very confident with that.

Andrew G. Didora - Bank of America Merrill Lynch

Great. And I guess just to follow up a little bit on Hunter's follow up to Jamie, obviously, another airline spoke of some weaker domestic pricing out there in the market yesterday. So with your 4Q comments, it seems like you're not seeing this weakness spillover into your markets. Can you maybe talk about what you are seeing within the domestic pricing environment right now?

Donald B. Casey - American Airlines, Inc.

This is Don again. I mean, what we are really observing is just carriers are matching other carriers' prices. In our case, for anybody flying into our hubs, we have been matching their fares since the middle of 2015. So from a competitive perspective, nothing has changed for us. And in fact, we're quite excited about rolling out Basic Economy because that is the tool we've been waiting for to put in place in the fourth quarter of this year. That's going to allow us to continue what we are already doing, which is matching the fares of anybody that flies in and out of our hubs. But it's also going to give us the opportunity to generate more ancillary revenue and generate more upsell to the product that we offer to customers today.

Andrew G. Didora - Bank of America Merrill Lynch

Okay. Thank you.

Operator

We will take our next question from Duane Pfennigwerth with Evercore ISI.

Duane Pfennigwerth - Evercore ISI

Hey. Thanks. Look, you guys have done a really nice job improving your revenue trends for the last year since you made some big leadership changes late last summer, so you clearly deserve credit for that. I wanted to ask you some follow-ups on Basic Economy. Can you talk about any positive share shift you may be seeing from the fact that you don't have it yet, have you noticed any positive share pickup out of Chicago in June and July?

Derek J. Kerr - American Airlines Group, Inc.

We've really only rolled out Basic Economy to 78 markets. We anticipate that this is going to be beneficial in the long run. And from what we can see right now, it's going to be beneficial. It's producing the results that we want. And anything that others may or may not say hasn't really shown a heck of a lot in our numbers.

Duane Pfennigwerth - Evercore ISI

I guess the question is more in markets where you don't have it, but a competitor does. It seems like you'd be seeing some positive share shift.

Derek J. Kerr - American Airlines Group, Inc.

We saw some, I would describe it as fairly modest share shift in close-in bookings, but based on changes that have been made to United's pricing structure, we do not expect any of this to continue into the third quarter and that the impact in the second quarter was very marginal.

Duane Pfennigwerth - Evercore ISI

Thanks.

William Douglas Parker - American Airlines Group, Inc.

And indeed as we put it in place, it will actually increase our revenue generating performance versus where we are today without having it in play.

Duane Pfennigwerth - Evercore ISI

I appreciate that. I guess the question is doesn't inventory management still matter? And again, you deserve credit. You're clearly focused on – it seems like you care about pricing, but if an airline puts out garbage walk-up fares at Basic Economy and then adds $20 to it and calls it Main Cabin, isn't Main Cabin fare just a garbage walk-up fare plus $20?

Donald B. Casey - American Airlines, Inc.

If somebody flies into our hub, right? We are going to match their fares, right. And that is what we are going to go do. I mean, we do sell out, right? So we did do yield management in all of these markets and we sell out of the EOCC (31:44) pricing structure a very high percentage of the time, but that's all based on individual market, but we do yield manage. We yield manage up out of those pricing structures as demand warrants, but we will, with our basic product, match whoever flies in and out of our hubs.

Duane Pfennigwerth - Evercore ISI

Understood. Thank you.

Operator

And we will take our next question from Jack Atkins with Stephens.

Jack Atkins - Stephens, Inc.

Hey. Good morning, guys. Thanks for the time. Just sort of going back to the fourth quarter expectation that you outlined in the press release and some of the comments there, I guess thinking about having Basic Economy fully rolled out by the end of September, could you maybe comment on how accretive do you think that could be to the fourth quarter RASM number? Because I think that maybe is part of the optimism that you're sharing today.

Donald B. Casey - American Airlines, Inc.

I'm not going to give you a number because once we roll it out, we're going to have to figure out what the right price points are and kind of how it settles out in the marketplace. So, we don't have a specific number that we're going to add into the fourth quarter. We've had a number of initiatives, right, that we've had all year that we've seen the benefits to. As Doug mentioned, 2017 is (33:05) more of a 2016 than 2017. And we expect all of the improvement we've seen through the first two quarters, right, to continue in the fourth quarter because of the initiatives that continue into the fourth quarter.

Jack Atkins - Stephens, Inc.

Okay. Don, thank you for that. And just to stay with you for a moment, if you could maybe just expand on the comments earlier just from a geographic perspective, just curious the trends that you're seeing in Asia, other carriers have commented on continued deterioration as they move through the second quarter and into the third quarter in Asia. What are you seeing there? Are you seeing the same thing? And then in Europe the comments, I think, were generally positive in the prepared remarks. Now that we're getting more towards the shoulder season of U.S. travel, would you continue to expect to see the same type of positive trends, I think, which have surprise to the upside in Europe thus far this year?

Donald B. Casey - American Airlines, Inc.

Let me just start with the Pacific. I mean, our situation in the Pacific is a little bit different, right. So in the Pacific for us, okay, we've rolled out a lot of new service. We started four new services from Los Angeles last year. We're going to lap the fourth of those new services in September, Los Angeles-Hong Kong. So from our situation, okay, we're now just kind of growing into the capacity that we had out there.

In addition to that, we've improved our premium product in the Pacific. We didn't get to a full lie-flat product until February of this year. We're seeing very strong demand for our premium product in the Pacific. So, the combination of kind of lapping all of our new service and growing into that capacity as well as the improvements that we've made in the premium product may be changing our profile compared to others, but the Pacific, again, we've had a couple of positive quarters and the third quarter looks very similar to us.

As far as Atlantic goes, Atlantic is challenging. The fundamentals are challenging. There is excess capacity in the marketplace. The capacity is being driven by low-price carriers. What's offsetting this for us is, again, strong Premium cabin performance, again partly because premium market is strong but plus we believe we now have the industry-leading premium product on the transatlantic and we're seeing very strong demand for that product. We're seeing strength in U.S. point-of-sale demand which is also important for us. And last year we had relatively low load factors, so we're able to increase load factors. So strong Premium cabin performance combined with load factor gains, it really offset what is a really weak coach pricing environment.

Jack Atkins - Stephens, Inc.

Great. Thanks again for the time.

Operator

And we will take our next question from Savi Syth with Raymond James.

Savanthi N. Syth - Raymond James & Associates, Inc.

Hey. Good morning. If I could dig a little bit more on the corporate share comments, could you provide any color on the progress there? And even to the extent that I appreciate the Premium Economy comments about when that gets rolled out, but are all your international fleet – is that now have free lie-flat on a very competitive product? And are you gaining share from that aspect as well?

Robert D. Isom - American Airlines Group, Inc.

Don can help me out here, but we're definitely seeing share gains from our product on all fronts. And again, that's in place this summer for the first time, so adding to strength, and as we look to Premium Economy, it's just on a limited number of aircraft right now – just ten aircraft. By the end of the year, it'll be 63 aircraft, and I think in the first quarter...

Donald B. Casey - American Airlines, Inc.

77.

Robert D. Isom - American Airlines Group, Inc.

77 – end of first quarter of 2018, 77. But we do anticipate that that strength will continue to hold as well.

Donald B. Casey - American Airlines, Inc.

I'll just say, on the corporate front, this is the third in a row where we've seen both gains in our share and also our share gap in the corporate market. We've also seen stronger yields, so average ticket values are up. We've seen particular strength this quarter in professional services, industrials and in financials, so again, we're very pleased with our performance in corporate.

Savanthi N. Syth - Raymond James & Associates, Inc.

That's helpful. Thank you. And then if I may follow up as one more way to kind of crack the 4Q issue here, just looking on a two year-over-year basis that you mentioned for looking at 2Q and 3Q, if I look at 4Q it seems like a tougher comp just on two year-over-year basis, which is why I'm kind of curious is, is the difference between like 3Q and 4Q, is that kind of the Brazil Olympics and the fact that you gained from some of the technology outages last year? And so that's not having those pressures in 4Q is what really drives that outlook? Because if I look at it on two-year basis, it doesn't seem to have an easier comp.

Donald B. Casey - American Airlines, Inc.

Okay. Let me take that. Again, we've been improving our sequential performance now for six straight quarters, and so once you go over one quarter, the comps do get harder. But we had some specific things related to this quarter that put us off trend line that were baked into 2016 last year. You've identified a number of them. The other big issue we had last year was there was a lot of disruptive pricing action in the marketplace last year, in the third quarter. We ended up with actually a price advantage for a period of time which helped us materially in the third quarter last year. Again, we look at the trend line, we look at the initiatives we have and the traction they have, and with Basic Economy rolling out in the fourth quarter, we see an improvement over the third quarter.

Savanthi N. Syth - Raymond James & Associates, Inc.

Got it. All right. Thank you.

Operator

And we will take our next question from Helane Becker with Cowen and Company.

Helane Becker - Cowen and Company, LLC

Thank you, operator. Hi, team. Thank you very much for the time.

William Douglas Parker - American Airlines Group, Inc.

Hi, Helane.

Helane Becker - Cowen and Company, LLC

Hi. I would like to ask an unrelated question. I think you guys have talked about something like $2 billion to $2.5 billion in revenue opportunity over the next few years that you see from some of the things that you're doing, and I'm just kind of wondering one of the things you needed was obviously buy-in from labor and – so I wanted to know, have you seen significant improvement in their on-time performance and their participation and their buy-in to your plans since the labor agreements went into place?

Derek J. Kerr - American Airlines Group, Inc.

Well, Helane, I'll tell you this. I think our team has always been behind us, and from our perspective, we want to make sure that we're supporting them in the ways that we need to and we can so that they can do their jobs that they want to do even better. And that's what we see. We see people that really can make use of new tools, new technology, and support from the leadership team.

And so I'm pleased with where we're headed. We have buy-in, people get excited about new aircraft, people get excited about new product in terms of seats, they get excited about lounges and flagship dining. And as we take a look forward, as you noted, we have a lot of confidence in the revenue initiatives that we have coming forward. And some of those are finishing off reconfiguration programs and looking at even some others. And it's finishing off product launches that from basic and premium that we think are really going to pay off.

So all-in-all, we're optimistic and very pleased with the support we have from the team, and that's only going to grow as we get stronger.

Helane Becker - Cowen and Company, LLC

Okay. Great. Thank you so much for that. And then just one other question on IT investment. As we look forward and think about your investment in the products that you are doing, but also what – and I know I think I asked this question last time as well – what about back-office in ensuring that cyber-attacks and IT outages and other things don't impact you? Can you just talk a little bit maybe about the redundancies in your systems, and how you are ensuring – because I think I saw also you're going to the cloud, IBM cloud, right, services for some of your system? So I'm kind of wondering how that all ties together if you could talk a little bit about that.

Maya Leibman - American Airlines Group, Inc.

Yes. This is Maya, and I'll take that question. When we think about our technology investments, they fall into a few different camps, and one of those camps is what we call ensuring the reliability and stability of our systems, because we know how disruptive that can be to our customers and to our employees. So we will always have a big chunk of investment focused on things like improving our disaster recovery capabilities, making sure that we are replacing systems and components that are end of service life, and certainly protecting us against cyber-related initiatives. So big chunk of investment is focused on that and that will always be the case going forward.

Helane Becker - Cowen and Company, LLC

Okay. Thank you very much, I appreciate all that insight

William Douglas Parker - American Airlines Group, Inc.

Thanks, Helane.

Operator

We will take our next question from Brandon Oglenski with Barclays.

Brandon Oglenski - Barclays Capital, Inc.

Hey. Good morning, everyone, and thanks for getting me on the call. I guess I want to come back to Helane's question because I feel like on the last earnings call, Wall Street was taking a pretty shortsighted view on the pay increases. So, I don't know, can we revisit the philosophy here on pay and how you encompass that into closing the margin gap? We know where Delta's guidance is for next quarter, and that was quite an issue for your competitor last week. So I guess, Doug, can you just talk about how you can get to better profitability long-term, and how that pay philosophy works into that outlook?

William Douglas Parker - American Airlines Group, Inc.

Yes, look we are not particularly concerned about how we measure our success versus others. What we care about is making sure we're doing everything we can to make American everything it can be, and to do that it's important to us that our team is properly engaged and that includes compensation. So we – it has been a long history here at American of labor discord that we are working hard to overcome, and that includes working really hard to rebuild trust with some people that lost trust over lot of times.

So what that means to us is we need to make sure our team understands that we're here to support them. They know exactly what to do and how to do it. Our job is to make sure they have all the tools and products they need to go take care of customers and really do so well. And we're doing all that, as Robert described.

But it also means that we'll live up to the commitment we made when we did this merger, which is we're going to – if we have an airline that has the revenue generating capabilities of other airlines, we need to be able to pay our people as other airlines do. Because of the way those two contracts have transpired, we've gotten to a point that in those two cases our team was going to be working for less than their peers at other airlines for a few years. That didn't seem right to us. So we addressed it. And we made that commitment to the rest of the team. If we find that in the future that we have – their peers that are doing the same job that they do at other airlines but not doing as well as they do, they should know that the company is going to address that, as we should.

So we feel really good about that commitment, and it's one that is going to help us move forward. My own view is all the things we talked about in terms of product enhancements that we're doing and all the capital investments we're making are going to be sub-optimized if we continue to treat our team members the way they feel as though they've been treated in the past.

So the way to actually get those investments to achieve their real value is to let our team be excited and fired up about the company they work for and give them an environment that they know cares about them so that they can go take care of our customers. And that's what this is for. It's for the long-term, not the near-term. We know it's the right idea. We knew it was the right idea when we did it, and we did our best to impress that upon you on the last quarter's call and I'm certain it'll play out over time.

A decent time for me to make the point that, again, we're in this for the long term and we look at investments in the long-term and we look at this mid-contract pay increase as a long-term investment as well. And we feel good about the long-term. When we get on these calls, we spend a lot more time talking about the near-term than we do internally; that's fine. That's something that you all care about a good bit more than we do, and our job is to make sure that we address those concerns for you all.

I'll tell you, though, when we talk to our shareholders, these are the same kind of conversations we have. We talk a lot more about the long-term with our individual shareholders, and we're really pleased to see how our shareholder base has gotten to be a lot more long-term holders because I think they appreciate what we're doing at American to build for the long-term.

So anyway, it's a long way to be saying we don't just look at a world that says how is it going to affect next quarter's earnings? We look at a world that says what's it going to do the make sure that American over time produces the kind of returns for our shareholders that they deserve? And that includes making investments in the near-term that'll pay off in the long-term.

Brandon Oglenski - Barclays Capital, Inc.

I appreciate that response, Doug. And I guess as we look out over the long-term, I know you guys are going to have an analyst meeting in couple months. Maybe we'll save it for that. But is there any reason why you think your airline, your network can't be industry-leading from a return perspective or a margin perspective?

William Douglas Parker - American Airlines Group, Inc.

I don't know. It depends on what the others do. What I know is what we've said in the past, and again, the best evidence I can give you is the way we compensate our executives. We've built an airline that we know over time – and indeed, in the near-term time, not in the distant future – that today should be able to produce $5 billion pre-tax earnings in a normal year, $7 billion in a really good year, $3 billion in a not so good year. That's the company we have here. That's what we believe we have. That's not just a goal. That's how we build our incentive compensation plan for our team.

If we have a year where we make less than $5 billion pre-tax, our executives get less than target bonus. If we make $5 billion, they get target bonus. If make more than that, they get – and if we make less than $3 billion, they're not going to get a bonus at all. That's what we've built, and we feel really good about where we are in that regard today.

As we look to next year, we'll talk more about that as we get to earnings – as we get to our Investment Day and as we get closer to 2018. But 2018 looks like a year that we can – again, it certainly doesn't look like a year that can't be one of those target years. So we feel really good about where the company is today, what our prospects are for the future, and we're really bullish for our investors, for our team members and for our customers. The investments we've been making for the last few years are beginning to pay off already and there's a lot more ahead. So we're excited.

Brandon Oglenski - Barclays Capital, Inc.

Thank you.

Operator

And we will take our next question from Joseph DeNardi with Stifel.

Joseph DeNardi - Stifel, Nicolaus & Co., Inc.

Yes. Thank you very much. Just two questions on the card program. I'll try and get more creative next quarter. So, Derek, just on the accounting of it. Is it fair to say that the revenue from selling miles, which flows through the passenger revenue line, has costs associated with it, those costs being providing free travel or some other reward? But that the revenue from selling miles, which flows through the other revenue line, does not have much in the way of costs, negligible bag fee waivers, lounge access, that type of thing. Is that a fair characterization?

Derek J. Kerr - American Airlines Group, Inc.

I mean, we lump it all into one. I mean, the amount that goes through the other revenue line is more the marketing driven side of things, but we lump it all into one. There's expenses for all of it to provide travel for our frequent flyers. So there is a definite cost to it. As you talk about over the past time, all we had said is that the increase in the new credit card deal that we did was more rate driven than it was volume driven. It was just an increase in the rate as we went forward and negotiated with our cardholders. So we had said that that came at not too much of a cost. But if you look at the overall program, there is costs associated with both of those dollars that come in to provide travel for our frequent fliers.

Joseph DeNardi - Stifel, Nicolaus & Co., Inc.

Okay. And then you mentioned or quantified the average upsell on the Premium Economy side. Can you do the same on the Basic Economy side on the 50% upsell on Basic Economy, what's the average upsell?

Donald B. Casey - American Airlines, Inc.

Okay. This is Don, again. I think we've set the structure. These are our beta markets at $20 upsell, and $40 upsell in the close-in bookings. But as I said earlier, even though that's the upsell, the yield management system will potentially sell up from that, beyond that, right. That's just the starting point. So if we just look at the initial sell-up point, it's about $23 because most of the volume is at the $20 sell-up rate.

Joseph DeNardi - Stifel, Nicolaus & Co., Inc.

Great. Thank you.

William Douglas Parker - American Airlines Group, Inc.

Thank you.

Operator

And we will take our next question from David Vernon with Bernstein Financial House (52:21).

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Thanks for taking the question, guys. With the Premium Economy, can you give us a sense for what percentage of the international seats, when it's fully rolled out, will be premium versus regular economy? And whether you have any plans to expand the Premium Economy into the U.S. market as well?

Robert D. Isom - American Airlines Group, Inc.

I don't know if we have a number to...

Donald B. Casey - American Airlines, Inc.

It's 20 to 28 seats a plane.

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Okay.

Donald B. Casey - American Airlines, Inc.

These are wide-body airplanes that have 250 seats, 280 seats, so.

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Yes...

Derek J. Kerr - American Airlines Group, Inc.

And there's no plan right now...

Robert D. Isom - American Airlines Group, Inc.

And there's...

Derek J. Kerr - American Airlines Group, Inc.

...to go domestically.

Donald B. Casey - American Airlines, Inc.

No plans domestically, yes.

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Okay. And I guess as you think about maybe longer-term, the vision around the flagship experience, if we were to just, say, look out five to seven years, what do you think is going to change about the travel experience on American? Like, what's the vision about what you can do from a customer experience perspective that you think will be either special or unique or will help you, kind of, deliver a better travel experience over the next, call it, five to seven years?

Derek J. Kerr - American Airlines Group, Inc.

Well, this is the start of it. So the flagship lounge and flagship dining product we have plans to expand over the next year, 1.5 year. And that's a continuation of making sure that we're meeting the needs of a premium traveler. So whether you're taking a look at the hard product on the aircraft and making sure that we have the best first- and business-class hard product in terms of seat and entertainment, whether you take a look at our product on the ground with flagship check-in or the lounges, and then in terms of how we serve our customers with technology and with our personal attention through things like the AAdvantage program.

We've got all the tools, and the great news is that there's more coming in every one of those categories. So when we take a look at the premium customer, we think that things are definitely going to be improving, and they're going to have value for the money they spend on American.

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

Do you envision things like agentless boarding and things like that, like more automation, kind of, hitting the ground-based operations as well? I'm just trying to get a sense for how you think this is going to shift. Do you think there's some potential there to change that experience in a meaningful way?

Robert D. Isom - American Airlines Group, Inc.

Well, yes, and Maya can help me out here, too. But, look, customers demand gratification instantly in many respects, and so we want to give them what they want and what they need, whether it's personal attention or technology to make their days easier. So the process for a customer in the airport is going to get better and better from a baggage perspective and also from a transit through the airport and onto the aircraft. And the real advantages I think for the vast majority of customers that we can provide is that when things do go wrong, or when things are disrupted, we can make things a lot better in giving options on an immediate basis.

And then, personalization is something I think that is out there. The more that we can stay connected with our customers, the more that we know what they want when they want it, and we have means to deliver it. Maya?

Maya Leibman - American Airlines Group, Inc.

(55:51).

J. David Scott Vernon - Sanford C. Bernstein & Co. LLC

All right. Thanks for the time.

William Douglas Parker - American Airlines Group, Inc.

All right, thanks.

Operator

And we will take our next question from Kevin Crissey with Citi.

William Douglas Parker - American Airlines Group, Inc.

Hey, Kevin.

Kevin Crissey - Citigroup Global Markets, Inc.

Good morning. Hey. Thanks a lot. Maybe one, I'm not sure if it's maybe for Don. If an airline files a fare on its website that differs from the ATPCO filing, how quickly do you see that? And how does that affect your pricing strategy, generally?

Donald B. Casey - American Airlines, Inc.

We track every channel. And if we see prices, we will respond to price action in any channel and every channel.

Kevin Crissey - Citigroup Global Markets, Inc.

So the match would be at the lower of the two fares. Is that the way you would take that?

Donald B. Casey - American Airlines, Inc.

We will match whatever fares are in the marketplace in our hubs, wherever they are.

Kevin Crissey - Citigroup Global Markets, Inc.

Okay. Thank you. Maybe bigger picture, can you talk about your view on the transatlantic, the thoughts of the effectiveness of the low-cost model over time, maybe the pros and cons? I don't know that it's a proven model, but maybe you could talk about the pros and cons of the low-cost model. Obviously, you're not operating that model, but it's important because it's obviously having an impact on transatlantic leisure demand. Thank you.

Robert D. Isom - American Airlines Group, Inc.

Yes. I think the best place to go to that is to the low-cost carriers. I can't really predict how well they're going to do. I can tell you, though, that we have confidence in being able to compete against them. The nature of our system and our hub-and-spoke network and the gateways that we have I think provide us with a unique opportunity to deliver a higher quality product, one that people will pay more for and with a lot of content that can't be delivered by the ULCCs. So it's going to be a competitive marketplace. We know that there's a lot of capacity coming, but we feel confident in our ability to compete, no matter what goes on with the ultra-low-cost carriers.

Donald B. Casey - American Airlines, Inc.

And I'll just add, one of the competitive tools that we have is our current (58:03) business arrangement with IAG. And IAG has the ability to go and launch new carrier called Level. And so we are participating in this market through our partnership with IAG because the Level services are part of our joint business relationship with them.

Kevin Crissey - Citigroup Global Markets, Inc.

Thank you so much.

Operator

And at this time, we'd like to take questions from the media.

William Douglas Parker - American Airlines Group, Inc.

Before we do that, operator, I just wanted – before we leave the analysts, a little gratuitous commentary from me again. Look, I just want to stress again how excited we are about where American is today and where we're headed. And again, I believe that if you go and model in what we've been telling you, which this is an airline that can produce over $5 billion pre-tax profits on a normal year, and that we feel today that we're undervalued.

It feels at least to us, to me, that things like these near-term pricing issues that have been happening for the last few years feel like still part of the market that just can't believe the industry has really gotten itself well and is looking for signals that indeed we're going to default back to the industry of the past, almost like this is too good to be true. And what we've noticed over the last few years is those tend to be buying opportunities.

So that's what this feels like to us. We felt undervalued before yesterday, and we felt more undervalued when yesterday was over. So again, I would just encourage those of you that can to look at American in today as to what we produced and what we will produce going forward, not so much about what's going to happen in the next three weeks, but more about what's going to happen in the next three years.

And we feel good about both those things, by the way. We just don't think what's going to happen in the next three weeks has any impact whatsoever in our value today, because that should be based on what we're going to do in the long term and over the next few years. And we couldn't, again, be more happy, more excited and more bullish about that.

So by no means we're trying to be dismissive of your concerns about the near term. We recognize that's important to some subset of our shareholders and we'll do everything we can to answer them. But just please understand that if we don't have quite the same level of concern as you do, it's because we don't view this as importantly as some of you do because we're in this for the long game, and we're going to keep being in it for the long game. But we'll do our best to keep addressing those concerns of you that care about the short term.

All right, media.

Operator

And at this time, we will take our next question from Andrea Ahles with Fort Worth Star-Telegram.

Andrea Ahles - Fort Worth Star-Telegram

Good morning, Doug.

William Douglas Parker - American Airlines Group, Inc.

Hi.

Andrea Ahles - Fort Worth Star-Telegram

So earlier this week, TWU was out protesting, picketing at DFW Airport and one of the things they talked about, while they didn't talk about specifics of the company proposal that was offered last week, they were making the point about outsourcing. That they want to see actually some of the work that had been outsourced under previous contracts brought back in-house. And I was wondering if I could get some comments from you and the team, about your thoughts on bringing some of the work that's currently being done by third parties back in-house?

William Douglas Parker - American Airlines Group, Inc.

Yeah, thanks. Again, we indeed are in the middle of negotiations. The company, in an effort to bring to a close, the contract negotiation that's been going on too long, put a comprehensive proposal on the table in the last week, and we'll leave that at the table. The IAM, TWU has done a nice job of doing that too, as you note. They haven't talked about specifics of our proposal. But look, what we'll tell you on the point you raise, American does more work in-house than any other airline, and nothing in our proposal seeks to change the amount of work done by our aircraft mechanics and where it's done.

So we'll continue to work with them, but we're trying to get two contracts to come together and they have different kind of work rules and scope clause and things like that. We put a proposal to our team that results in a contract for our IAM and TWU members that is industry-leading, just like we have in every other contract we've gotten done. So we're confident we'll get that done at some point in time. We need to continue to work through it with our team and we prefer to do it with them as opposed to talking about it in public, but as it relates to outsourcing, we again, American does more in-house than any other airline and that'll be the case going forward.

Andrea Ahles - Fort Worth Star-Telegram

Do you think you guys can come to an agreement before the end of the year?

William Douglas Parker - American Airlines Group, Inc.

I don't know, Andrea. Look, we'd like to. This is the one contract we still haven't gotten done. But again, not for lack of trying on either party's part. It's a very complex one. We're dealing with two separate unions that have formed a coalition alliance. Thank you. They have formed an alliance to work together. They're working together, but that's hard. They haven't worked together before. It's seven different work groups covered by this alliance, so two different unions, two different contracts, seven different work groups going through it clause-by-clause takes some time.

As you know, about a year ago we came to the conclusion that it was taking too long and that wasn't fair to our team, so we worked out an early kind of not joint agreement but an agreement with the alliance that allowed our team members to get significant pay increases and so that's happened. That's the good news is they're not far from industry-leading wages as we sit here today. So we've taken care of that part and now we've got to get this through a joint collective bargaining agreement. I know we will at some point.

If it's done by year-end or not, that's up to the negotiating parties to try and do that. We certainly are trying to do that by putting this comprehensive proposal on the table earlier this week, and we're waiting to hear back from the IAM and TWU and I suspect shortly we'll keep it at the table and hopefully hammer something out. What gives us encouragement, of course, is we've done this with every other work group. When we get done with them, our team has industry-leading contracts. That'll be the case here, so we'll keep working through it.

She's gone.

Operator

And ma'am, does that answer your question?

Andrea Ahles - Fort Worth Star-Telegram

Yes. Yes. Thank you.

Operator

Okay. And we will take our next question from Mary Schlangenstein with Bloomberg News.

William Douglas Parker - American Airlines Group, Inc.

Hi, Mary.

Mary Schlangenstein - Bloomberg News

Hi. Good morning. Don talked earlier about an average upsell on the Basic Economy and I didn't get those figures. Can I get those again, please?

Donald B. Casey - American Airlines, Inc.

Sure. So the structure we have in our test markets is a $20 upsell and a $40 upsell closer to departure. And the average upsell rates are $23 because most of the volume is happening further from departure, because as we get closer to departure we actually sell up out of the basic structure.

Mary Schlangenstein - Bloomberg News

Great. Great and if I can ask, hey, Doug, so I kind of hear you saying that the emphasis on RASM and other near-term numbers like that you think are misplaced in terms of valuing the company. So what would you see as a better measure? If investors want to look at something near-term, what would you rather see them look at?

William Douglas Parker - American Airlines Group, Inc.

The long-term. Look again, it's up to our investors to decide how they value a company and that's their job, and they know how to do it. So I'm not trying to tell anybody how to do it. Our point is simply this, as we look to the value of American Airlines, near-term pricing changes don't have any impact at all on what we think the value of our firm is. And none of these things feel like trends in the environment, they feel like noise. They feel a little bit like things shaking out. But what I know is this, we have an airline with a hub-and-spoke network that allows us to compete against anyone in and out of our markets for the long-term.

And we feel extremely good about that, and we are making huge investments in our team, in our product such that that network will be able to compete with anyone with similar networks. And as a result, what we know is we have an airline that's going to produce results in good and bad times that are going to give really nice returns for investors, give really nice product to our customers. And give a really great place to work for our team members, and we're excited about that. So again, we're not trying to tell anyone how they should value the company, rather just noting that when prices fall in the near-term, we don't go run off and change our five-year plan.

We don't go off and tell our executives that we're going to lower our target for your incentive compensation because someone else has gone and decided they're going to have some price skirmish for a while. But those are all short-term things and we aren't supposed to make decisions for the near-term. We're supposed to make decisions for the long-term. Our team is doing a phenomenal job of doing that, and we feel we are really, really bullish on the future. And as a result, we tend to talk about those things more than the shorter term.

Mary Schlangenstein - Bloomberg News

Thanks, Doug.

William Douglas Parker - American Airlines Group, Inc.

Thanks, Mary.

Operator

And we will take our next question from Conor Shine with The Dallas Morning News.

Conor Shine - The Dallas Morning News, Inc.

Good morning, guys. I was hoping that you guys could talk about the decision around the Boeing 737 MAX seating arrangement, why did you consider going to 29-inch pitch for some of those seats and how did your whole experience with that, how that's going to affect how you think about density decisions in the future?

William Douglas Parker - American Airlines Group, Inc.

Yeah. Conor I'll try this and anyone else can chime in. That decision again was one that was released not by us, but somehow in a way that I think over state of the situation, but that's fine. I mean what we had at one point planned to do on our 737 MAXes was get three rows in the aircraft to have – would have a 29 inch pitch notably. These are new state-of-the-art slimline seats, very high in comfort, but also much thinner than the existing seat. So 29 inches feels like something bigger than that. But nonetheless that piece of information came out on its own, and when it did, we got a lot of push-back from our customers, and most notably, from our team members, who care as much as anybody in the world about having the product they need to take care of the customers.

So when we started hearing from our flight attendants and others that, gosh, really. You're going to put us in a position where we need to explain to these customers that indeed this is necessary so that we can have one more row of main cabin extra for the rest of the airplane? It was an issue that we came to the conclusion wasn't the right decision to make, and again back to those long-term point, while we could convince ourselves that that might be able to produce somewhat higher revenues on the aircraft, what it was doing to our perception with our team wasn't worth it. So we decided to go back to 30 inches for those three rows, and again, 30 inches on a slimline seat which will feel more like 31 or 32 inches, and to go with one less row of main cabin extra.

It wasn't a hard decision for us, frankly. It was a decision that had been made in a different environment, and as we announced it, it was about to happen. When we got pushback from the team, we agreed with them. Rob?

Robert D. Isom - American Airlines Group, Inc.

No. Doug, the only thing I'd add is, it was never about more or less seats on the aircraft. It really is just one row of main cabin extra that was allowed that has just been converted back to a row of normal economy to produce the 30 inches. So it's a balance that we've got to constantly take a look at, and I think in this case we took feedback from all the right parties and made the right long term decision.

Conor Shine - The Dallas Morning News, Inc.

Thank you.

William Douglas Parker - American Airlines Group, Inc.

Thanks, Conor.

Operator

And we will take our next question from Susan Carey with Wall Street Journal.

William Douglas Parker - American Airlines Group, Inc.

Hey, Susan.

Susan Carey - The Wall Street Journal, Inc.

Good morning, everybody.

William Douglas Parker - American Airlines Group, Inc.

Good morning.

Susan Carey - The Wall Street Journal, Inc.

Two little questions. First of all, on your China Southern investments, the $200 million, I assume that's a done deal now. And I wondered what percentage of China Southern you own as a result of that investment? That's number one.

Stephen L. Johnson - American Airlines Group, Inc.

Hi, Susan. It's Steve. We actually haven't closed the transaction yet. We're waiting for some final government approvals related to the slot exchange. We expect to get those, I was going to say this month, but in early August and can close the transaction then. And I actually haven't done the calculation, but it's sort of 3%-ish of China Southern.

Susan Carey - The Wall Street Journal, Inc.

Okay. I'm asking obviously because I'm wondering, given the airline casino that opened yesterday among Delta, Air France, VA and China Eastern, whether, a), you have an opinion about that transaction just from afar? And secondly, are you kind of motivated? Or have you thought about investing in your partners in the same manner?

William Douglas Parker - American Airlines Group, Inc.

Susan, it's Doug. We are very happy with our partners and the partners we have in place, particularly those that we either have joint ventures with or are working to get joint ventures with. We always look at ways we can strengthen the partnership. That may make sense over time. To date, it hasn't made sense for American with any of our partners except China Southern where indeed we needed to help a new partner appreciate that we were in this for the long term. But the rest of our partners, one, they're on pretty sound financial footing and aren't coming to us looking for investments, and two, already have really long term commitments with each other.

So, again, not to opine on what others are doing. I'm sure they have reasons that I'm sure make sense, but my guess is the basis for those reasons is ensuring that you have long term partnerships where everyone is equally committed. We feel that way already, but as we move forward that may or may not be something that makes sense for us and our partners. But really happy right now with the partnerships we have and the long term commitment to each other.

Susan Carey - The Wall Street Journal, Inc.

Thank you.

Operator

And we will take our next question from David Koenig with Associated Press.

David Koenig - The Associated Press

Hello. Susan asked my question. Let me pivot then to kind of a Washington question. There's been no visible action yet on your complaint against the Gulf carriers, and the Senate looks like it's not going to go along with privatizing air traffic control. And they're raising the PFC which is going to mean higher prices for your customers. And I'm wondering, how do you think Washington is doing on your issues? And are you concerned that your agenda is not going to get enough attention because of all the chaos and other issues that are going on there?

Stephen L. Johnson - American Airlines Group, Inc.

This is Steve again. We aren't concerned. I mean let's face it, there's a lot going on in Washington, and there's a lot of drama. And we have tough issues, issues for which there's some real opposition, and it's not really a great environment in Washington in July of 2017 to have the kind of discussions that we need to have to really get these issues focused on and across the finish line. I mean, we're all looking forward to everybody being able to escape Washington for the August recess and have some time to get away from the drama. That'll be an opportunity to have some really good discussions about issues and hopefully we'll be able to reset and focus on other things in September and October and be able to move these issues forward.

David Koenig - The Associated Press

Okay. Thanks.

William Douglas Parker - American Airlines Group, Inc.

Thanks, David.

Operator

And it appears there are no further questions at this time. I'd like to turn the conference back over to our presenters for any additional or closing remarks.

William Douglas Parker - American Airlines Group, Inc.

Thank you all very much for your interest. Any questions, reach out to either Dan in Investor Relations or our corp com people for the media. We appreciate your interest in listening in. Thanks for your time.

Operator

And, ladies and gentlemen, that does conclude today's conference. I'd like to thank everyone for their participation. You may now disconnect.