Operator

Good morning and welcome to the American Airlines Group Second Quarter 2016 Earnings Call. Today's conference is being recorded. [Operator Instructions] And now, I would like to turn the conference over to your moderator, Managing Director of Investor Relations, Mr. Dan Cravens. Please go ahead, sir.

Dan Cravens

Thanks, Ashley and good morning, everyone and welcome to the American Airlines Group second quarter 2016 earnings conference call. On the call with us this morning is Doug Parker, our Chairman and CEO; Scott Kirby, our President; and Derek Kerr, our Chief Financial Officer. Also in the room for the question-and-answer session is Robert Isom, our Chief Operating Officer; Bev Goulet, our Chief Integration Officer; and Maya Leibman, our Chief Information Officer as well as Steve Johnson, our EVP of Corporate Affairs.

As is our normal practice, we are going to start the call today with Doug and he will provide an overview of our second quarter financial results. Derek will then walk us through the details on the quarter and provide some additional information on our guidance for the remainder of the year. Scott will then follow with commentary on the revenue environment and our operational performance. And then after we hear from these comments, we will open the call for analysts Q&A 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 cost, forecasts of capacity, traffic, load factor, fleet plans and fuel prices. These statements represent our predictions and expectations as to future events but numerous risks and uncertainties could cause actual results to differ from those projected. Information about some of these risks and uncertainties can be found in our earnings press release issued this morning and our Form 10-Q for the quarter ended June 30, 2016.

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

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

Doug Parker

Thank you, Dan. Thanks everybody for being on. Happy to report our earnings today, $1.6 billion pre-tax earnings, excluding special charges, that's the second best in our company's history. It's worst over the last year, which was the best. Last year, we made $1.9 billion on similar terms. I am not particularly happy about that, but that is revenue driven. Scott will talk more about that and the trends there.

On an EPS basis though, adjusted EPS, adjusted to the fact that we are booking taxes this year and didn't last year. You will see that our earnings were actually – EPS, adjusted EPS was actually up 7% even though the pre-tax earnings were down and that's due to our share repurchase activity, which Derek will talk more about. So, all-in-all, really great results for the team. They are the result of great work by a phenomenal team. We got 100,000 hardworking people in American Airlines. They are out there doing an amazing job of taking care of our customers and we are extremely appreciative.

So with that said, I will turn it over to Derek and then Scott to give you some more details.

Derek Kerr

Alright. Thanks, Doug and good morning everybody. As is our normal process, we did file our 10-Q and earnings press release this morning. And in that release, our second quarter 2016 GAAP net profit was $950 million or $1.68 per diluted share. This compares to our 2015 GAAP net profit of $1.7 billion or $2.41 per diluted share. Excluding special charges, we reported a net profit of $1 billion or $1.77 per diluted share versus the second quarter of 2015 net profit of $1.9 billion or $2.62 per diluted share.

As we talked about on our last two earnings calls, the company did reversed the val allowance on its deferred tax assets as of December 31, 2015. As a result, in 2016, the company is recognizing a provision for income tax that is substantially non-cash due to its utilization of NOLs. On a year-over-year basis, quarterly net profit in 2016 will not be comparable to net profit in 2015. Accordingly, we believe pre-tax profit and pre-tax profit excluding net special items is a better measure for evaluating year-over-year performance than net income.

On that basis, our second quarter net tax or pre-tax profit was $1.5 billion, equating to a pre-tax margin of 14.4% on a GAAP basis. Excluding special charges, our pre-tax profit was $1.6 billion, which resulted in a pre-tax margin of 15.4%. And as Doug said, both of these measures are the second best, second quarter pre-tax margin in company history. Excluding the effect of special items and the non-cash tax provision of $541 million, our second quarter 2016 adjusted fully diluted EPS was $2.81 per share, up 7.3% as compared to second quarter 2015, reflecting a 20% reduction in our fully diluted average share count.

Total capacity for the second quarter of 2016 was 70.8 billion ASMs, up 1.9% from the second quarter with mainline up 1.2% and regional capacity up 8%. Our second quarter 2016 revenue is impacted by a competitive capacity growth, continued global macroeconomic softness and foreign currency weakness. For the quarter, total operating revenues were $10.4 billion, down 4.3% year-over-year. Passenger revenues were $9 billion, down 4.4% driven by 5.3% yield – lower yields. Cargo revenues were down 10.4% to $174 million due primarily to a 12.7% decline in yields on international freight. Other operating revenues were $1.2 billion, down 2.1% versus the same period last year.

On July 12, we did announce a new credit card agreement with Barclays card U.S., Citi and MasterCard. This agreement extends and deepens American's relationship with its existing credit card providers and is expected to generate $200 million in pre-tax income, incremental pre-tax income in the second half of 2016. It's about $100 million each quarter, $550 million in 2017 and $800 million in 2018 with modest increases in later years of the agreement. Most of the increases will be reflected in other revenue.

Total GAAP operating expenses were $8.6 billion, down 3.3% versus the same period last year due primarily to a $530 million decrease in consolidated fuel expense. Our average mainline fuel price, including taxes for the second quarter of 2016, was down 25.5% year-over-year to $1.41 per gallon. Second quarter mainline CASM was 11.32 cents, down 4.6% year-over-year due primarily due to the lower fuel costs. Excluding special items and fuel, our mainline cost per ASM was 9.12 cents, up 4% year-over-year. This increase was primarily due to contractual labor rate increases for our customer service and res agents, and the introduction of our profit sharing plan. This rate increases were offset in part mainly by maintenance timing and lower selling expenses.

Regional operating cost per ASM in the second quarter was 18.78 cents, down 9.8% from 2015. Excluding special items and fuel, regional CASM has decreased by 4.6%. We ended the second quarter with approximately $9.5 billion in total available liquidity comprised with cash and investment of $7.1 billion and $2.4 billion in undrawn revolver capacity. The company also had $460 million classified as restricted cash. This is a reduction of $51 million since the last quarter. And during the second quarter, we generated $2.2 billion in cash flow from operations and paid $1.9 billion in debt.

During the quarter, the company completed several efficient financing transactions, including the issuance of a new $1 billion 7-year term loan secured by the company's mainline spare parts and $844 million in JFK special facility bonds. In addition, the company issued $829 million, 2016-2 EETC consisting of AA and A tranches, which was then augmented in early July with an additional $227 million B tranche, resulted in a total deal of $1.06 billion with a blended rate of 3.5%.

In the second quarter, the company returned more than $1.7 billion to its shareholders, including quarterly dividend payments of $58 million and a repurchase of $1.7 billion of common stock or 50.2 million shares. Since our capital return program started in mid-2014, the company has returned approximately $8.4 billion to shareholders through share repurchases and dividends. Including share repurchases, shares withheld to cover taxes associated with employee equity awards and share distributions and the cash extinguishment of convertible debt, our share count has dropped 29% from 756.1 million at merger close in December 2013 to 537.1 million shares on June 30, 2016. At the end of the second quarter, the company had approximately $1.2 billion remaining on its current share repurchase authorization.

Our liquidity of $9.5 billion at the end of second quarter was up slightly as compared to $9.4 billion at the end of the first quarter and remains well in excess of the $6.5 billion minimum liquidity we seek to maintain for the foreseeable future. As we discussed on our first quarter 2016 earnings conference call, we believe it is important to retain liquidity levels, higher than our network peers given our overall leverage from the fact that we have not yet completed our fleet renewal program. In regard to our fleet renewal program, when we merged in 2013, both airlines had widebody fleet replacement plans that overlapped in 2017 and '18. As referenced in our earnings release, in order to spread out the widebody replacement orders and our future aircraft CapEx requirements, we announced today that on July 18, we modified our purchase agreement with Airbus for 22 A350 XWB aircraft. Under this amended agreement, we will now receive our first A350 in late 2018. The deliveries are as follows; two in late '18 and five each from 2019 to 2022. This change reduces aircraft CapEx and PDPs by approximately $500 million in '17 and approximately $700 million in '18 and provides us with capacity flexibility.

As we discussed on our last earnings call, in evaluating our leverage we look at metrics such as net debt to EBITDAR as our fleet replacement program begins to normalize and with the deferral of our A350 aircraft deliveries. Going forward, our peak capital spending for aircraft will occur in 2016 and decline going forward. As we see it today, we expect our total net debt to follow the same path, peaking in 2016 and improving each year thereafter.

Turning to our 2016 guidance, we continue to monitor our capacity plans and in our IR update issued two weeks ago, we lowered full year system capacity guidance by a half point and are forecasting it to be up approximately 2%, both from a domestic and international capacity, they will both be up around 2%. So, mainline capacity will be $64.1 billion in the third and $58 billion in the fourth and regional capacity $8.19 billion in the third and $7.9 billion in the fourth. Year-over-year CASM excluding special items and fuel will be up approximately 4% to 6% and regional capacity is expected to be up approximately – or down excuse me, approximately 3% to 5%. While fuel prices have risen since the beginning of the year, we continue to expect to see significant savings in – on a year-over-year basis. Based on the forward curves as of yesterday, we expect to pay between $1.39 and $1.44 per gallon in 2016. In the third quarter, we expect $1.45 to $1.50, fourth quarter, $1.48 to $1.53. Regional, we expect third quarter $1.51 to $1.56 and in the fourth quarter, $1.54 to $1.59. Based on these prices, we expect 2016 consolidated fuel expense to decrease by approximately $1.3 billion year-over-year.

Using the midpoints of guidance we just provided along with the revenue guidance that Scott will give, we expect the third quarter pre-tax margin excluding special items to be between 12% and 14%. For capital expenditures, we still expect total gross aircraft CapEx to be approximately $4.4 billion in ‘16 with approximately $803 million occurring in the third quarter and we still expect non-aircraft CapEx to be $1.2 billion for the year.

In conclusion, thanks to the efforts of our more than 100,000 team members, they again delivered strong quarterly results. While we still have a lot of work to do to fully complete our integration, we are excited about the commercial initiatives our team has implemented as well as those they are working on and look forward to reporting on our continued success on future calls. Thanks again for your time this morning.

And I will turn it over to Scott will to talk about the revenue.

Scott Kirby

Thanks Derek. Let’s start but talking a little bit about our operational performance and then turn to the revenue environment. American’s operational performance for the first half of 2016 has been strong. On a year-over-year basis for the first half of the year, all performance metrics improved for both mainline and regional operations, especially D-zero, which was up 3.3 points for mainline and 10.3 points for regional and our mishandled bag rate which has been reduced by 24%. Of course summer thunderstorms and high load factors bring incremental challenges for our team, but the people of American Airlines are continuing to do a great job taking care of our customers and improving the operation month-in and month-out.

On the revenue front, 2Q PRASM came in at the high end of our forecast. And while it's still a challenging revenue environment, 2Q is better or less bad than 1Q, so we have at least started to see some second derivative improvement in PRASM. Domestically, consolidated PRASM was down 5%. We saw the strongest year-over-year performance in Phoenix, followed by DFW as our second best performing year-over-year hub. Internationally, as we are beginning to overlap the dollar strengthening last year, the impact of the stronger U.S. dollar and declining international fuel surcharges getting smaller and drove a 0.6% decline in PRASM.

The Atlantic was once again our best performing international region despite the high levels of capacity growth, with PRASM down 6%. Across the Pacific, PRASM was down 15% on 21% ASM growth with continued weakness in both Japan and China, but good PRASM results in Hong Kong and Korea. Latin PRASM was down 10%, but we saw a particular strength in Mexico and Argentina and an improving trend in Brazil. Looking forward, we expect the third quarter to continue showing modest second derivative improvement in year-over-year PRASM. Regionally, we expect the Pacific and Atlantic to remain challenging with double-digit year-over-year PRASM declines. But domestically and in Latin America, we expect continued improvement relative to the second quarter, which will result in low single-digits PRASM declines in both entities.

We see particular strength in Mexico and it appears that capacity cuts are finally starting to catch up to the declining demand in Brazil. Also, we will begin benefiting from the new credit card deals that most of that revenue will show up in other revenue. With that, we expect our total RASM – not passenger, but total RASM to be down 3.5% to 5.5% year-over-year with about 1 point of that coming from the new credit card deals. And going forward, we plan to continue guiding to total revenue – to total RASM. While we don't really have enough bookings or data to have a forecast that's any more reliable in the analyst community, as we look to 4Q and beyond, we expect to see continued second derivative improvement in the year-over-year total RASM performance and we are looking forward to getting back to growing RASM.

We're also excited with our plans to introduce basic economy towards the end of this year and premium economy at some point in 2017. We believe that product segmentation is a transformative change in how we segment the product to give all of our customers choice in what they prefer, whether it's more inclusive product bundle or just the bare bones, low price. Also as Derek mentioned, we also lowered our capacity guidance for the back half of the year, which is really just a normal and natural reaction to a decline in year-over-year PRASM and higher fuel environment.

In conclusion, we still dislike negative RASM, but we feel good about the path that we are on to get back to RASM growth. We continue making gradual improvements in our core results. Our new credit card deal will add significantly to revenues over the next few years and we have some big opportunities ahead of us with product segmentation. When you put it altogether, we feel very good about the foundation that we are building for the long-term, which will enable us to run the world's best operation and drive higher revenues.

Doug Parker

Thank you, Derek. Thank you, Scott. Operator, we are ready for questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] We will take our first question from Mike Linenberg with Deutsche Bank. Please go ahead.

Mike Linenberg

Yes, hey. Actually I think Derek, you may have called this out just competitive capacity growth is being an issue on the revenue performance, where did you see – like where was that most egregious, like which markets and maybe it's more domestic and maybe this is actually more a question for Scott to answer, I know you did call it out, Derek, which of your domestic markets may be have seen the most degree just sort of conditions from a competitive capacity growth perspective? Thanks.

Derek Kerr

Well, look there is lots of capacity growth everywhere, it's not just domestically, lot of capacity growth across the Atlantic and Pacific in particular, lot of capacity growth actually in the Caribbean and Mexico. The one place, internationally, at least, where we finally started to see capacity start to right-size to – well, I don't know right-size the right term, start to at least adjust to the demand environment is South America, where Brazil actual saw declining capacity and we continue to see declining capacity going forward. Domestically, I mean, it's mostly across the board. We still see higher growth in Dallas out of Love Field. The good news for us is that, that growth as we get to September, we will overlap the last phase of Southwest growth. And so at least the head to head competitive environment for us relative to where it has been will improve in September, but really there has been a lot of growth everywhere. Los Angeles has been a high growth market, but I don't think other than Dallas, I would single out any particular market for high growth. It's been across the board.

Mike Linenberg

Right. Just a quick follow-up to Derek, on the NOLs now, I mean, now you are booking taxes, but at what point – do you have an estimate when you believe you will be paying cash taxes? And I guess I would just presume that just based on current profitability trends, our cash taxes going to become a real thing and maybe what, 2018, 2019, any thoughts on that?

Derek Kerr

Yes, we are thinking right now, 2019 or 2020, but it just depends on also aircraft purchases and other things like that. So, I think we are looking at more '19 to '20 for cash taxes.

Mike Linenberg

Great. Thanks a lot, guys.

Doug Parker

Thanks Mike.

Operator

And we will take our next question from Rajeev Lalwani with Morgan Stanley. Please go ahead.

Rajeev Lalwani

Thanks for the time. Scott, just a question for you. We have heard a lot from other airlines as far as pressure is on closing yields and that sort of thing. What are you seeing there, just thoughts going forward? That's the first one.

Scott Kirby

Okay. So, I guess we are seeing something a little different. You know all of our competitors said it. Closing yields are still down year-over-year, they are still negative, but we certainly haven't seen another like down. Actually, I would have said probably quite really optically that things look marginally less bad for us on closing yields. But some of that is probably because we do I think have a little bit of a different competitive environment on a year-over-year basis. We have had some huge headwinds from a competitive perspective. Dallas Love Field is one of those big headwinds domestically that drove a lot of capacity growth in our market. And now we are starting to overlap that. And so we have what would be a more normal comparison with the rest of the industry looking forward. And so that probably means that we are seeing something perhaps it's a little different than our competitors on a year-over-year basis. Secondly, we have had on a year-over-year basis, while we still probably have the most exposure to ultra low-cost carriers of any airline. They aren't going in our markets anymore at least to a large degree. And so we have less of that incremental pressure and they are adding capacity in other places. And when they do that causes closing yields to decline in those markets. But we have already had that and we are overlapping now on a year-over-year basis, where they are effectively flat in our markets. And then third, we have been less involved in some of the pricing, I don't think is the right word, pricing issues going on between airlines. We have been involved on the periphery, but some others have been more involved in lowering fares in each others markets than we have and so we have probably benefited from not being quite as involved in that.

Rajeev Lalwani

Right, thanks. Doug, if I could ask you a quick question. As it relates to buybacks, you have obviously been pretty aggressive. Why not be even more aggressive where maybe taking the company private or something like that just given your confidence in the model?

Doug Parker

Well, I think we are being adequately aggressive and properly aggressive. Our view, as we stated many times is after we go through and make sure we are investing in all the right things, our people, the airline, our customers paying off high cost debts, the question then becomes of the cash we continue to generate in excess of that, what should we do with it. And certainly, given our view of the future that we described and where the market has the stock right now, it appears to us that the best use of that cash is to buyback our shares and we are doing so, I think in a reasonably aggressive way, but that's the current plan.

Rajeev Lalwani

Thank you.

Operator

Our next question comes from Helane Becker with Cowen & Company.

Helane Becker

Thanks, operator. Hi, guys. Thanks for the time here. I just have a question about headcount. Do you think that there are extra people still on board – I guess that's a bad way to phrase it relative to the merger and the consolidation? And do you think that as you look out another couple of years that number starts to increase at a slower rate?

Derek Kerr

Yes. Helane, I would say the answer to that is yes. Our number one job is to get through the merger and complete the merger. So, there are areas where we do have extra headcount to make sure that we get the operation running right, to make sure that we complete the integration. So yes, I believe over time, we will pull it back and become more efficient, but I think right now we are doing the right things to make sure that we get everything running right and get the integration done. So, I think over time, it will come down, but over the next few years as we look forward.

Helane Becker

Okay. And then just another process question, I couldn't find it in the 10-Q real quickly this morning, but the intangibles from the balance sheet declined, did you have to make any adjustments for slots at Newark or anywhere else?

Scott Kirby

Yes, we did, but it wasn't very big. It was in the $20 million range for us, but it was very small from the Newark perspective. But we did make an adjustment and wrote those down to zero.

Helane Becker

Okay, great. Thank you for your help.

Doug Parker

Thanks, Helane.

Operator

Our next question is from Hunter Keay with Wolfe Research. Please go ahead.

Hunter Keay

Hey, guys. Good morning.

Doug Parker

Hey, Hunter.

Hunter Keay

So I think, Scott, you said in the past that you guys expect to have the best margins in the industry amongst the legacy airline peers and that's probably looking a little bit less likely now. So if we would sort of like start here and pick one financial-oriented metric that you want American to lead the pack kind of the next 12 months from today, what would it be?

Scott Kirby

Well, look, I still want us to have the highest pre-tax margins amongst the network carriers. I still think we will get there. And I think we are on a good path. We took a step back from, well, a few big things that disproportionately impacted American and these kinds of things are cyclical and they will eventually come back. But you look at Venezuela first, which had RASM that was four times our system average and the country fell apart. And you had Brazil which was 80% something above system average and the country fell apart. Those were massive, massive headwinds that drove 3 to 4 points, just those two issues, 3 to 4 points of system PRASM and 3 to 4 points of margin decline. So, the hell we had to overcome to get back on those things was bigger, because those big macro exogenous events disproportionately impacted American. That said, it feels like we are – those things are about to be in the rearview mirror. Brazil is no longer a negative. Venezuela is still a big negative. It's still – RASM is going to be down 35% this coming quarter again, but it's coming off a much smaller base. And so now you are something that we call out as a system level impact, because it's coming off a smaller base. So, we have had some really big headwinds between that Dallas Love Field growth and those headwinds are now in the rearview mirror and we have a more normalized, at least on a year-over-year basis comparison to the rest of the industry. And I think you are starting to already see our – as we look out our RASM results start to reflect that. We have also been at least one hand tied behind our backs in the last few years as you get through integration and you have all your resources, you have systems locked down that even when you know you want to make changes you can't, because during the middle of converting the systems and our hands are getting untied now. We still have some of that work left to do but there is more coming. We would have had basic economy and premium economy, which I have said I think I will be disappointed if they are not $1 billion a year. We have those done by now if we hadn't been in the middle of integration, but we have been in the middle of integration and we have had to get through that. So, I think we are going to continue to knock those kinds of and many other smaller projects out along the way and that we are on a good path we get our credit card deal done. Others get theirs done ahead of time, we get ours done. So I feel really good about the path that we are on and ultimately our goal is to have the highest pre-tax margins amongst the network carriers.

Hunter Keay

Okay. So, you mentioned some of the ULCC competitive headwind shifting, do you feel vindicated, I mean I guess what you said here is, what we have learned is that it pays to kind of go nuclear when this stuff happens, so do you feel vindicated that this is happening now or do you – now that this is sort of settling down, do you feel like, well, maybe there could have been like a little bit more of a tactical way to do this without setting the house on fire, but we had to destroy the village to save it type thing or is there any like lessons learned that you can extrapolate going forward about how to compete maybe more tactically or do you have no regrets?

Scott Kirby

I don't agree with any of the commentary about nuclear, house on fire, any of that...

Hunter Keay

Fine, whatever you want to declare?

Scott Kirby

I think that there was absolutely no choice, but to compete and to match pricing of nonstop competitors, so just absolutely no choice. And it's not a matter of vindicated or any other of those words. It's what you have to do. And it's what we have done and it's the right strategy.

Hunter Keay

Thank you.

Doug Parker

Thanks Hunter.

Operator

Our next question comes from Jamie Baker with JPMorgan. Please go ahead.

Jamie Baker

Hey everybody.

Doug Parker

Hi Jamie.

Jamie Baker

I am trying to figure out a way to avoid using the term nuclear in my question now, but bazooka versus rifle or something like that. But listen Scott, you have avoided fuel hedging in the past, believing that fuel prices and passenger demand would broadly move in conjunction with one another, if you look at current revenue and GDP trends though, that time held relationship had decoupled for the first time since the financial crisis or the advent of the Internet and by the way, fuel and capacity have been volatile in the past, yet the revenue to GDP relationship was broadly unaffected, so I have two questions, first, what explains the disconnect, is it secular or self-inflicted and two, if the relationship is decoupling and continues to do so, then your primary argument against fuel hedging is no longer valid thoughts?

Scott Kirby

Okay. So I will try on both of those. First, I think there still is a relationship between fuel price and revenues. It comes with the lag. I have historically said four months to six months, one of our competitors said nine months. It does come with a lag. And I think revenues will be higher in the fourth quarter than it otherwise would have been if fuel was lower. Now fuel prices, whatever it was yesterday, $47 a barrel, while it took a very brief spike down to $35 a barrel, I doubt capacity ever adjusted all the way down to $35 a barrel and you saw earnings improve dramatically as a result. So I am not sure what the right comparison is if it was $35 a barrel or $47 a barrel where people were planning capacity from, but I think there still is a link. Second, I think there has been another structural change in the industry. And that has been in particular the growth of ultra low-cost carriers that was a structural change, a structural change that required a structural response. The structural response is twofold. It's one, to compete with them, which we are doing. And the second one is product segmentation. It has been a structural change in the industry, where 20 years ago we segmented customer demand based on fare rules. And if you are a business traveler, you are – the higher the fares, the low fares, which were designed for leisure customers, required a Saturday night stay, you had to buy 21 days in advance and that didn't work for business travelers. That kind of segmentation doesn't work in today's world anymore. And so we have to change the model. And changing the model is going to product segmentation, which is what basic economy and premium economy are all about. Now, I wish we could have done that by snapping our fingers like we could make a change in the fare filing and these ultra low-cost carriers grew that we could have immediately affected that change, but we couldn't. And so we had to compete first and then we will get to segmentation starting with basic economy later this year and premium economy next year. And I think that's going to address the secular change from ultra low-cost carriers. But we have taken a leg down because of that and I think we will recover once we get those things in effect. As to the fuel hedging question, there is two reasons to not hedge fuel and actually I would have said the tie to revenues is maybe the second one. The biggest reason to not hedged fuel is because it's of rigged game that's impossible to be. Fuel prices, most of the time, are trading at contango. So while fuel is $47 a barrel today, if we try to buy fuel for a year from now, its well north of that. In addition, we all realize the risk that you take if you just do countless callers. And so what most people do and the prudent view is that you should buy the options. So if you want to buy an option for a fuel a year from now, Q – you are going to pay an $8 to $10 option premium. So fuel prices have to go up varies on times depending on how big the contango is and how high volatility is, but in the 30% to 50% range just to breakeven. And when you are playing a game that you have to have oil go up 30% to 50% to breakeven, it's impossible to win in the long-term. You can be days that you win, but it can be months that you win, but it is impossible to win in the long-term.

Jamie Baker

Okay, I appreciate the input on both parts of the question. I will turn the mic over to somebody else. Take care gentlemen.

Doug Parker

Thanks Jamie.

Jamie Baker

Thanks Doug. Thanks Scott.

Operator

Next, we will take Dan McKenzie with Buckingham Research. Please go ahead.

Dan McKenzie

Hey. Good morning. Thanks guys.

Doug Parker

Hi Dan.

Dan McKenzie

Hey Scott, British Airways, they cut their earnings outlook following the Brexit vote and I am wondering if you can talk a little bit more about what Brexit might or might not mean for American as we look ahead. And then separately, I am wondering what you can share about BA's willingness to work with you to optimize the transatlantic flying as we look ahead?

Scott Kirby

So first on Brexit, I think in the near-term and I will define near-term as being until the UK actually leaves the EU. So 2-plus years, depending on when they trigger Article 50. There is sort of I think of it as three effects. One is the currency effect, which is a pretty clear negative. Actually we look that currency by currency, what has the biggest year-over-year impact, it's been the Brazilian real for a long time, it's now the UK pound because of the decline in currencies. And by the way, we generated about 4% of our revenues are sold in British pound. So currency decline is negative. The second point is that it will happen over the near to medium-term, the indirect direct impact, I actually think will be positive. When I say direct impact, I mean the number of people having to fly back and forth across the North Atlantic, particularly business customers as there is a lot more consultants, lawyers, bankers that are likely to be flying back and forth, figuring out what the heck this means and what are we going to do. The third and most concerning thing that will be – that has the potential to be negative is in the near to medium-term, is if it creates business confidence problems. We have seen historically, that when there is business confidence, one of the first things businesses do is cut travel and entertainment budget. That's not something that would uniquely affect the UK or the EU, it will be a more broader impact. I was gratified to see that while the market fall for two days after the Brexit vote, it has bounced back and that's usually a pretty good indicator of confidence or highly correlated with confidence. And so I think it's unlikely that we are going to see a big change of confidence. So all of which means, I think or the next few years at least, there is not going to be much impact from Brexit when you sort of do those three items. Don't have tons of data, we have a months worth of data so far and our booked revenues have improved in the month since Brexit happened, at least relative to where they were before. So hard to see any evidence that it's a big problem. Longer term, the issue is going to be obviously what happens with the UK economy, what happens with the banking industry in particular because that is a big component of revenue across the transatlantic and what happens from a regulatory framework. But near-term, I don’t anticipate an awful lot of issues.

Dan McKenzie

Comprehensive answer. Thanks. Derek...

Doug Parker

Thanks Dan.

Dan McKenzie

The board asked also. Well, I appreciate it. Derek, the reduced CapEx and cash tax perspective addresses key investor concerns that I have been getting, just given the net debt coming down, does that also mean gross adjusted debt will start coming down in 2017. And then as you think about the longer term leverage targets say, 3 years out, what could that look like?

Derek Kerr

Well, I think that if we look at CapEx, we talked about it being at $4.4 billion this year, goes down to $4 billion next year and then down to $2.1 billion, $2.5 billion, $2.5 billion. So the significant reduction in the CapEx will help all those leverage ratios out. So I think those will be benefited as well going out throughout the year. So, I think all of our metrics from a leverage basis get better as we go through ‘17, ‘18, ‘19, ‘20 as the aircraft CapEx gets reduced over that time period.

Dan McKenzie

Okay. Thanks, guys.

Doug Parker

Thank you, Dan.

Operator

Our next question comes from Duane Pfennigwerth with Evercore. Please go ahead.

Duane Pfennigwerth

Hey, thanks for the time. Scott, I wonder if you could put a finer point on RASM expectations for Europe or the UK specifically. What are you expecting in terms of year-to-year change in RASM to the UK in the September quarter versus say the second quarter?

Scott Kirby

Well, look, Europe is probably the only region in the world that I think is going to get sequentially worse from the second quarter to the third quarter. Specifically, it will be about the same on RASM, domestic and Latin, as I said in my opening comments, going to get better. We do expect Europe to get worse, although it's really core Europe more than it is the UK. Europe has several almost, I guess, three strikes against it looking forward. It's, one, there is more economic uncertainty. It's not just from Brexit, there is more economic uncertainty and it's a challenging economic environment in Europe, so the macro is not good. You got accelerating capacity growth across the Atlantic. So, it's a second strike for Europe. And third is currency. So, the one impact of Brexit that actually is identifiable negative is currency weakness. So, those three things, I mean, that's the one region of the world that we think is actually going to sequentially get worse in the third quarter, but it's really not a UK issue, it's actually more core Europe than it is UK from our perspective.

Duane Pfennigwerth

Appreciate that. You wouldn't care to put a finer point on it of how much you expect RASM to be down next quarter?

Scott Kirby

Well, I said double-digits in my opening comments and I am not going to put a finer point on it than that.

Duane Pfennigwerth

Okay. And then the comments on Latin are really interesting, maybe you could help us put some context around Brazil. Could you remind us how much your capacity is down 3Q versus 2Q and what the shape of RASM you are expecting? So for example, we have heard some others that maybe long-haul international to Brazil went from like down 35 to down 25, which is sequential improvement, but it's still pretty weak for you, your capacity cuts are much greater than that, so maybe revenues or maybe RASM is still sort of flattish. Any help you can give us there will be appreciated?

Scott Kirby

Yes, we have cut capacity – I don't know 3Q or just 2Q, we started cutting capacity in 2015 and we could see these results clearly deteriorating. We were surprised actually in 2015. I think, every carrier that flies from Brazil to the United States not only increased capacity, but increased capacity by double-digits, except for American Airlines. So, I think we are probably down

35% to 40% from where we were back in ‘14 today. But in the second quarter for the first time, we actually saw industry capacity come down. It’s going to come down even more in the third and fourth quarter. And as a result, Brazil, which was running down kind of 35%, in the second quarter RASM was down 13%, in the third quarter, we expect it to be positive. Now, we are getting a boost in the third quarter from the Olympics. So, I wouldn’t necessarily expect the fourth quarter to remain positive. Although our guess is right now that the fourth quarter will remain positive. There has just been an awful lot of capacity come out and you just got to such a low level, I mean, the RASM will still be down. I don’t know the number, 40%, 50% from where it was at the peak even if it turns positive in the third and fourth quarter, but it’s certainly – it feels like it’s not getting worse anymore. It’s not really on – it’s coming off a low base. It’s not really on a rapid recovery, but it does feel like it’s not getting worse anymore.

Duane Pfennigwerth

Thank you for that. So, maybe RASM positive on capacity down double-digits for you?

Scott Kirby

I don’t know what our capacity is right now. As I look at it on our overall longer time horizon, over a longer time horizon, we are down probably close to 40%, but I don’t know what it is 3Q versus 2Q.

Duane Pfennigwerth

Okay, thank you for the detailed answers. Thank you. Appreciate it.

Doug Parker

Thanks.

Operator

Next, we will take Julie Yates with Credit Suisse. Please go ahead.

Doug Parker

Hi, Julie.

Julie Yates

Good morning. Thanks for taking my questions. Derek, one for you on the CapEx decline in 2017 and 2018 starts to free up some free cash flow, what are your priorities, are there additional opportunities to prepay debt, and is this meant to help with the pension funding requirement coming in 2019?

Derek Kerr

Yes, two things. One it will be we are going to use cash to complete the integration and continue to do all the projects that we are – we have got on the list as Scott talked about, basic economy, premium economy, cash will definitely go to that first. As we look at pension requirements, our first pension requirement payment is in '19. We have a small requirement in '18, but the biggest requirement is in '19. We do have the possibility to do that early on the pensions in '18 if we want to get 80% funded in the '18 timeframe. So, that's a possibility to do, but it's not required to do our requirement is in '19 to do that. So, I think the biggest uses are going to be making sure that we have enough CapEx. We have $1.2 billion this year in CapEx. We expect that to maintain, if not grow a little bit in '17 and '18 just due to all the projects and the backup demand that's there for everybody. So, I think that's where we will more likely go than any early pension payments, the requirement and the pensions in '19.

Julie Yates

Okay, very helpful. And then Scott, one for you, from the last year, we have seen the weakness from competitive actions is really contained. How much do you worry about that when you observe what's going on in other markets with the other airlines that you mentioned?

Scott Kirby

Well, look, it's a really competitive environment and it's still a yield in RASM, negative environment across the board. So, we are impacted by that. I think we get better at competing in that environment. The more experience we get with it, we work – learn things that work, learn things that we can do better, but the biggest thing we can do really is the structural response. And I know on these calls we typically focused on what's going to happen in the next quarter or the next three weeks and have a pretty short-term focus on it. But the biggest thing we can do is get the product segmentation right, not just for investors, but for our customers, where we can give customers what they are looking for, whether they want a really cheap barebones low price or whether they want a product that has more amenities and is a higher quality product. And it's taking us time to get that done, but that's really the right structural response. So, we feel pretty good about where we are. We think that we are on a continuing trajectory and we expected to have a positive trajectory to get back to positive PRASM that happened this quarter and we expect it happen in the second quarter and expect it in the third quarter. And we think we are going to continue on that trend. So, we wish it was PRASM was positive today. We wish we had a benign competitive environment, but we have what we have and we think we are making good progress.

Derek Kerr

And Julie, this is Derek. Just one follow-up to that question. From a debt – non-aircraft debt payments, next year, it's only $100 million for us. Year after that, it's only $600 million. We do have an unsecured bond in '18 and we will – if there is any opportunities to prepay any high cost debt, which we have done a significant amount of and we will do at any point we can, we will use that cash to prepay any of that. We don't have any planned in '17 and '18, but if we find things that we can prepay early, we will use any cash to do that in '17 and '18.

Julie Yates

Okay, great. And then, Scott…

Doug Parker

It's only because we have a lot of our employees who listen into these calls and you mentioned that pension, I just want to make sure I explain to everybody kind of what's going on there. The issue is you may or may not be doing that Julie. I mean, we are fully funded per some airline pension funding rules and more funded in that regard than our competitors on the pensions. We, at American, are required because of the way these – because of the fact, frankly, the American didn't file a bankruptcy and Delta Northwest did or Delta United did, we are required to move off that funding plan and two other funding plans sooner than they are. And as Derek said, I think that's '18 or '19 for us. So, that will require us to move up to a higher level at that time. We could do it today if we wanted to. This is not a funding issue. It will never be a funding issue. It's just what's the right time to pay debt amortizations, and this is – so we will pay that when – we will fund at that as we are required to. We are fully funded now higher than our competitors and will be funded at a rate higher than them when we do this. But we don't think – none of us think it's in the best interest of the company to go fund it in advance or to be over-funded on something that doesn't have a return. So we will keep doing until that we are well aware that it's not an issue whatsoever and it's fully manageable, it can be funded now.

Julie Yates

Okay. Thanks Doug. And then just one last one for you Scott, on corporate, it's been a pretty big topic on some of the other calls and you guys haven't mentioned it, what – can you give us an update on what trends you are seeing from a corporate perspective?

Scott Kirby

Well, they continue as they have been. We had corporate demand up and we continue to win share. I think corporate revenue was down 1% for us in the quarter, so obviously it's outperforming the rest of the system. But I think it's much like it has been. Corporate demand is strong, but we have a lot of low fares in the markets, so we are getting the deal right now.

Julie Yates

Got it. Thanks so much.

Operator

Our next question comes from Darryl Genovesi with UBS.

Darryl Genovesi

Hi guys. Thanks for the time. Maybe I would like to follow-up on Jamie's question Scott, with regard to some of the secular trends that were perhaps one of the thing you would called out, the growth of low cost carriers, but one of the things that I have been thinking a little bit harder about more recently is that we have also seen a lot of frequency acceleration here over the last few years and I am just wondering if maybe you thought perhaps, the quality of the schedule having deteriorated a bit could have also driven some of the decoupling that we have seen in that historical relationship between airline revenue and GDP and just any thoughts around that?

Scott Kirby

I don't think so. I mean one of the things that is a close analog to that probably is every airline has increased density on aircraft. And so we have done it, but all of our competitors have as well. And at least as with regard to RASM, that we typically think of those extra seats is coming in at 50% of system RASM. And so we put another 12 seats on the 737-800s that, that 12 seats is 6% of capacity, it means that all those flights come in, the RASM is 3% lower than it otherwise would have been, they are profit positive. But I think that is – that is probably a change that has driven lower RASM, at least across the industry, it has a corresponding benefit on the cost side of course, that would drive lower RASM. But we still have high quality schedules for business travelers. And I don't think business travelers are flying less because maybe you have 14 flights a day in a market instead of

15 flights a day, I don't think you are really losing any business. But people are resigned to stay home because of that.

Darryl Genovesi

Okay. And then you had also mentioned that you thought the Olympics were going to be a positive, down in Brazil, I remember 2 years ago when we had the World Cup down don't there, you saw some very close-in revenue deterioration, bookings deterioration, which I think was related to hotel availability, do you think that, that's likely going to be an issue again this time?

Scott Kirby

Well, usually, the Olympics, World Cups, conventions are a negative for revenues, because business travelers just stay away, because they can't get hotels and worry about the crowds and some business travel dries up. We have seen that in all other Olympics. We have seen that in the World Cup. In this case, Brazil is so bad that there is no business traffic or close to no business traffic. As of this year, I think there will be a positive just because Brazil has fallen so much before. 2 years ago, I would have thought the Olympics would be a negative and it would have been 2 years ago. But today, because things have fallen so much, they are going to actually be a positive.

Darryl Genovesi

Great. And then if I could squeeze one last one, I just like a point of clarification for Derek. Derek I think you said CapEx was coming down by $500 million in '17 and $700 million in '18, is that just aircraft CapEx or is that total CapEx and I think you said there was also an offset on the non-aircraft one?

Derek Kerr

That's just aircraft CapEx. Right now, we are showing $1.2 billion in '16 for non-aircraft CapEx. We think it will go up to $1.5 billion in '17 and then probably $1.5 billion, I just put $1.5 billion for both '17 and '18 as we finish off and then will drop off in '19 and '20. So I am trying to get done with all the basic economy, premium economy, all of the interior work that we are doing and all of the completion of all the merger activity we will have higher non-aircraft CapEx in '17 and '18, but then get back to that $1.2 billion, $1 billion run rate in '19 and '20.

Darryl Genovesi

Would you just provide the total gross CapEx as you see it today for those years?

Derek Kerr

Yes. I have 5.6 in '16, 5.5 in '17, 3.6 in '18, 3.6 in '19 and 3.2 in '20.

Darryl Genovesi

Thank you.

Operator

Our next question is coming from Savi Syth with Raymond James.

Savi Syth

Hi, good morning. Actually if I could first ask a follow-up to Julie's question on the corporate demand, can you just talk about like what the volume trend has been over the last several quarters and if that's similar or have you seen maybe a deceleration in that trend?

Scott Kirby

I think they have been similar. Not a real change from the corporate demand environment.

Savi Syth

Alright, great. And then just switching to the kind of the non-fuel cost side, on the pre pre-agreed profit sharing basis, if I look at the full year guide, it seems that there is a lot of pressure here in 2016, I am just wondering what's driving that and when we might see some of the kind of the benefits from merger or integration related benefits benefiting the cost side and maybe just some early thoughts on what we might see from the headwinds and tailwinds in 2017?

Scott Kirby

Yes. I think what's driving this year is primarily for a full year effect, it's salaries and benefits and adding back in the profit sharing. So that of a full year, we have guided right around 5, that's almost 4.5 of it. The third quarter change from the second quarter is really driven by maintenance timing. I think we had a 1.7% good guy in maintenance in the first quarter, 1% in the second quarter and it's shifting almost exactly opposite in the third and fourth quarter with about a 1.6 headwind in the third and a 1.4 headwind in the fourth. So it's really a shift in the maintenance timing. Year-over-year, our maintenance is flat, it's up 0.1, so it's virtually flat. But it's the timing of things moving from this year in the third and fourth quarter more than last year being in the first and second quarter, so that's really the year-over-year timing. As we look forward, we don't – we still have one contract to do that is not in our guidance, that we are still working hard to get our mechanics in our RAMP contract done and we want to get that done as soon as possible. That would be the biggest headwind going into next year from a CASM perspective. Other than that, we believe we should be in the zero to 2% range going forward and we don't see any major CASM headwinds looking out into '17 or '18.

Savi Syth

If I may follow-up on that, from a gauge standpoint, what's the trend is there going to be, kind of maybe it's a zero to 2% would rely on the gauge improvement?

Derek Kerr

Gauge improvements from an aircraft perspective?

Savi Syth

Exactly?

Derek Kerr

There is still some gauge increase. Some of that is going as we modify the aircraft, so maybe 0.5% of that will be gauge driven.

Savi Syth

Okay. And then just from kind of on the regional side, there is not a lot more left then, from kind of up-gauging there?

Derek Kerr

Correct. There is only from a delivery perspective, we only have about 12 aircraft of gauge coming in '17, so there will be some effect from the '16. We had 42 aircraft coming in '16, so there will be a little bit affect that next year. This year, we had a gauge difference of about, from an ASM perspective, of about 3.3. Next year, it's probably about half of that, 1.5 points to 2 points on the regional perspective.

Savi Syth

Alright, great. Thank you.

Operator

Next, we will take the question from Joseph DeNardi with Stifel.

Joseph DeNardi

Yes. Thank you. Good morning. Derek and Scott, I just want to talk about kind of the capacity reductions you announced, I guess it was last week, one of your peers have said that it's essentially too expensive for them to pull capacity starting in fourth quarter, so I just want to understand, when you guys ran the numbers on pulling ASMs, was it dilutive to earnings and you were just willing to accept that to try and regain some pricing power or was it not?

Derek Kerr

No, we think it's the right thing to do. We think its earnings positive in that world. I mean look, in a world where RASM is declining and/or fuel prices were going up, it just becomes mathematically true that everything across your system gets a little worse. And so the bottom 1% has a higher probability that it's no longer profitable. It is true that you can't get 100% of the cost out in the short-term that does drive CASM pressure for us, but we think that, that the capacity changes we made are both revenue and earnings positive beginning in the fourth quarter even though we can't get 100% of the cost out.

Joseph DeNardi

Okay, okay. And then Derek, you have talked in some detail about the CapEx and debt profile over the next couple of years, can you just talk about just on the interest expense line when and at what level that, that number peaks and then starts to come down over the next couple of years?

Derek Kerr

On the interest expense line?

Joseph DeNardi

Yes.

Derek Kerr

Let me see. Let me try to grab that for the 5-year plan. Go ahead and ask another one and I will pull that question and I will pull that answer.

Doug Parker

What else you got, Joe?

Joseph DeNardi

I was going to try and stick to two, so I will let somebody else get on.

Doug Parker

We are still long enough...

Derek Kerr

It should stay pretty stable where we have it right now. So, our interest expense line in '16 is forecast to be right about at $1 billion and we forecast it for the next. Depending on what we do, I think, right now, we expect to finance a fair amount of those aircraft, so if we do that, we will reduce that pretty much commensurate with what we bring on. So, our interest expense should stay pretty flat over the next 5 years under that methodology. And we have reduced the cost of the debt from 5% down almost to 4% debt, which is as we have refinanced and financed these aircraft at really attractive rates we have reduced our overall cost of debt down to around 4%.

Joseph DeNardi

Great, thank you very much.

Doug Parker

Thanks, Joseph.

Operator

Our next question comes from Jack Atkins with Stephens.

Jack Atkins

Great. Thanks for squeezing me in here guys. I guess just to go back to the revenue initiatives and cabin segmentation for a moment, I know the plan is to have basic economy by the end of this year. But can you give us a sense for when you would expect those initiatives to really start having some noticeable improvement on the P&L in terms of your RASM or PRASM?

Derek Kerr

So basic economy, I think we will start to have an impact probably on March of next year what I would say. And then premium economy, while we will roll it out at some point in '17 because it will also be tied in – we are going to treat premium economy like a separate cabin essentially. So different than what other airlines might call premium economy today, more expansive, more what it looks like or more how it's treated internationally or how we are going to treat it internationally as a separate cabin. And because of that, it will have impact on the frequent flyer program and so that will probably be for 2018 really because we need to tell our frequent flyers in advance how it impacts the frequent flyer program.

Jack Atkins

Okay. And then just a quick follow-up on that then, is there a way to sort of put some brackets around the value you would expect that to generate to your earnings stream over the course of the next, call it 3 to 5 years?

Scott Kirby

I am going to be disappointed if it's not a $1 billion a year.

Jack Atkins

Okay, thank you very much.

Doug Parker

Thank you.

Operator

And now we will begin the media portion of the question-and-answer session. [Operator Instructions] And we will take our first question from Susan Carey with Wall Street Journal. Please go ahead.

Susan Carey

Good morning. Two probably for Scott. I think, Scott, at the outset, I understood you to say that your 3Q guidance is going to be for RASM, down 3.5% to 5.5% and I believe I understood you to say you were abandoning PRASM and you were going to be adopting the RASM model going forward. Am I getting that right?

Scott Kirby

Well, I didn't say abandon, but yes, that's right. It's the better metric to look at more an increasing percentage of our revenues come in the other revenue line. The credit card deal is obviously a big component of that. But also as we move into a world of basic economy and premium economy, there will be a higher amount of revenues that come in other revenues, and that's really the most important metric. So, we are going to be guiding to RASM on a going forward basis.

Susan Carey

And okay, so – and the other question I think an analyst asked it, you said there are – Brexit is not really going to have a big impact on you for the foreseeable future, except on the ForEx front, but I think the guy asked, what are you going to do about coordinating, with VA across the pond in case there has to be some kind of capacity adjustment? Is it premature to talk about that right now or is that something that's in your planning horizon?

Scott Kirby

Well look, we have a great relationship with IAG and we talk to them all the time about what the right amount of capacity is and will this continue in the normal course in that process and we will react as we see things happen in the market, but there is nothing specific to talk about today.

Susan Carey

Thank you.

Doug Parker

Thank you.

Operator

Our next question comes from Jeffrey Dastin with Reuters.

Jeffrey Dastin

Hi, thank you for taking the question. Perhaps I missed this, but could you specify any markets or if there is particular region that will be impacted by the Airbus deferrals?

Scott Kirby

Well, we didn't specify and there really isn't, because we still have to work through the plans on where we are going to fly with the existing fleet. It – really, what this does is give us flexibility. All these aircraft were scheduled to be replacement aircraft for existing aircraft and so we can extend some of the leases longer to keep the existing flying and/or growth plans in place or given a weak international environment, we can keep some of those requirements in place as they were and pullback on what our growth plans otherwise would have been. So, it really just gives us flexibility.

Jeffrey Dastin

Great, thank you. And one follow-up question or unrelated question, how are bookings shaping up for cities in Cuba so far?

Scott Kirby

You know, I don't know.

Jeffrey Dastin

Right, thank you.

Doug Parker

We will get some of that back to you, Jeffrey.

Jeffrey Dastin

Great, thank you.

Doug Parker

Sure.

Operator

Next, we will take Edward Russell with Flightglobal.

Edward Russell

Hi, thank you for taking my questions. I just wanted to understand why you are choosing to do the A350 deferrals now? You have the U.S. Airways and American order books back in 2013, so why the decision to do this now versus a year ago or so?

Scott Kirby

Well, in order to defer, you can't just unilaterally decide to defer aircraft and call Airbus or Boeing up and say, hey, we are going to defer aircraft and they say, okay. You have to work it out with them. And so we have just needed to find a point in time, where it was in Airbus' best interest to defer the orders and ours. And so the timing is really about when it works for both sets of partners.

Edward Russell

Okay. I mean, one of the things that comes up I think of is I mean, Airbus has already started cutting metal for first half '17 deliveries at this point. So, I mean do you have any color on where you penalized for doing a deferral now or that it was just in the best interest?

Scott Kirby

No, this was something Airbus also wanted and so we were able to work out a win-win for Airbus and American and...

Doug Parker

Yes, hey, Edward, it's Doug. I mean, look anyway, first off as you know, we came in with two realms of two large fleet orders and we have been trying to get them better coordinated this helps. And on the Airbus front, you should talk to them, but it's been a very popular product as you know and they sold a lot of them and they are trying to meet all their customers' needs and this deferral, I think, was consistent with that.

Scott Kirby

We did defer 4 787s last year, so...

Doug Parker

So, it worked out well for us and presumably worked out well for Airbus, but we did not – we certainly did not pay any penalties for it.

Edward Russell

Got it. Thank you very much.

Operator

And our next question comes from Mary Schlangenstein with Bloomberg News.

Mary Schlangenstein

Hi, good morning. There has been some kind of dire forecast out of Europe, European airlines on the impact on travel demand from the terror incidents. Are you guys seeing anything or do you expect to see anything from that?

Scott Kirby

Well, we don't have anyway of knowing why bookings are lower or why revenue is weaker. Europe is the one area that is going to sequentially get worse in the third quarter than the second quarter. But whether it's that or whether it's the economic weakness or whether it's Brexit or whether it's just the currency impact or whether it's all the capacity growth, there is a lot of things that could be driving it and it's probably all of the above.

Mary Schlangenstein

Yes, thank you.

Operator

And our last question is coming from Ted Reed with The Street. Please go ahead.

Ted Reed

Thank you. Two quick things. First of all, first Delta said they were going to cut to UK by 6%, then United said incremental cuts, and now you are saying no cuts to UK. So what's the difference is just the traffic doing better than everybody thought?

Scott Kirby

Well, I don't think we said anything about what we are going to do in the UK.

Ted Reed

What are you going to do in the UK?

Scott Kirby

We haven't said anything.

Ted Reed

Alright. And the other thing I wondered about is I was surprised – people were surprised when you put the 787-9 on to go to Madrid instead of to Asia, what was your thinking behind that?

Scott Kirby

Well, we have got a partner in Madrid with a hub there and we just thought it was the right route to come. There is going to be 78s, 9s that will be flying to Asia. We are taking a lot of deliveries and they will be coming, but starting it off, it worked for the aircraft rotation and worked flying into one of our partner's hubs.

Ted Reed

Alright, thank you.

Doug Parker

Thanks Ted.

Operator

And that does conclude our question-and-answer session. I would like to turn the conference back over to our speakers for any additional or closing remarks.

Doug Parker

Alright. We have no additional closing remarks other than thank you and please let us know if you have any further questions. We appreciate your time.