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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Alaska Air Group 2023 Second Quarter Earnings Call. (Operator Instructions) Today's call is being recorded and will be accessible for future playback at alaskaair.com. After our speakers' remarks, we will conduct a question-and-answer session for analysts.

I would like to now turn the call over to Alaska Air Group's Vice President of Finance, Planning, and Investor Relations, Ryan St. John.

Ryan St. John

Thank you, operator, and good morning. Thank you for joining us for our second quarter 2023 earnings call. This morning, we issued our earnings release, which is available at investor.alaskaair.com. On today's call, you'll hear updates from Ben, Andrew and Shane. Several others of our management team are also on the line to answer your questions during the Q&A portion of the call.

This morning, Air Group reported second quarter GAAP net income of \$240 million. Excluding special items and mark-to-market fuel hedge adjustments, Air Group reported adjusted net income of \$387 million. As a reminder, our comments today will include forward-looking statements about future performance, which may differ materially from our actual results. Information on risk factors that could affect our business can be found within our SEC filings.

We will also refer to certain non-GAAP financial measures such as adjusted earnings and unit costs, excluding fuel. And as usual, we've provided a reconciliation between the most directly comparable GAAP and non-GAAP measures in today's earnings release.

Over to you, Ben.

Benito Minicucci - Alaska Air Group, Inc. - President, CEO & Director

Thanks, Ryan. And good morning, everyone. Our solid second quarter results reflect the strength of the leisure demand environment to date as well as our team's unwavering commitment to operational excellence and reliability. I am thankful for their focus which has helped us capitalize on this busy travel season to produce these great results.

Our 18.3% pretax margin will likely lead the industry coming in above 2019 margins despite higher fuel and structurally higher costs. Our earnings per share of \$3 was \$0.83 higher than 2019 levels, bringing us above 2019 on a year-to-date basis and beating consensus by 11%. The strength of demand this quarter was evident on June 30 when we flew the most passengers in a single day in Air Group's history. And at a 99.5% completion rate, we ran one of the best operations in the country as we continue to prioritize completing flights and serving our guests with care. This was 1.7 points better than 2022 and 0.3 points better than 2019.

Heading into the busy summer period, we have planned and prepared our airline for peak flying, and our teams are executing. Over the 4th of July weekend, we led the industry in completion rate at 99.8% and on-time performance at 85.1% while flying a 90% load factor. As we approach the rest of the year and beyond, it is clear our environment is evolving as domestic leisure fares have recently started to come down from their peaks.

Delivering on our targets will not be without challenges, but we remain focused on restoring the tenets of our resilient business model, driving improvements in efficiency and productivity and controlling unit costs to continue to deliver strong financial performance. We remain confident in hitting our financial targets this year including our adjusted pretax margin of 9% to 12% and earnings per share of \$5.50 to \$7.50.

Now turning to an update on our business priorities and progress. We have chosen to prioritize reliability and are running a strong operation like we have historically done. Not only do our guests deserve this level of commitment and excellence, but it is imperative to restoring stability, improving predictability, capturing revenue and building a foundation to drive further improvement to the business.

Our investments in training, aircraft and staffing have enabled us to meet a higher level of flying. Higher completion rate performance has surpassed our initial expectations, driving approximately half of the 3-point increase of capacity in our full year guide. Productivity is also improving as we adjust to new work behaviors amidst a more stable operating environment and work to close the gap to 2019 levels.

Boeing has also continued to be a great partner, delivering according to expectations despite continued disruptions within their supply chain. Earlier this month, we welcomed our 53rd MAX into the fleet. The up-gauging benefit of these aircraft are significant. While departures were down on 1.3% year-over-year this quarter, higher gauge, coupled with mainline utilization exceeded 2019 levels by 4% at 11.5 hours per day. And drove capacity up 9.9% year-over-year as we continue to leverage our fixed cost assets as much as possible.

As we transition to a fully Boeing fleet at Alaska, this efficient growth has helped us derisk our growth plan within a constrained industry operating environment. Given our expectation of continued strong operational execution, adequate staffing and efficient growth, we have raised our full year capacity guide to 11% to 13% versus 2022. As we work to restore all areas of our network to pre-pandemic levels, we are confident in our resources to meet this higher level of flying and balance our growth aspirations with a consistent commitment to excellence.

Our business is configured to compete, and we've doubled down on these core advantages to reinforce our foundation for profitable growth. We are returning to our historical strength as a single fleet operator and have rebuilt our foundation of operational excellence. We continue to push incrementally more on productivity and costs and still expect to be one of the only in the industry to drive unit costs lower year-over-year even when factoring in our industry-leading performance-based pay, which several of our peers exclude.

We are executing on our commercial road map and making progress on revenue initiatives. Our balance sheet remains unimpaired coming out of the crisis with leverage well within our long-term target range, and we have line of sight to full year earnings per share on par with 2019, despite structurally higher labor costs and at least 30% higher fuel costs.

For decades, Air Group has adapted and will continue to do so to produce consistent, profitable growth. As you well know, this industry is challenging, yet we remain focused on the drivers of our long-term success. Restoring and strengthening our competitive advantages - operational excellence, cost discipline and high productivity - in a consistent and measured way will continue to position us well now and far into the future.

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

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Thanks, Ben, and good morning, everyone. My comments today will focus on second quarter results as well as our revenue outlook for the rest of the year. We produced very solid second quarter results. Our record high revenues of \$2.8 billion were up 6.8% versus the second quarter of 2022 and above the high end of our guide, driven by strong leisure and close in demand.

To close out the quarter, on June 30, we recorded our second best revenue day in our history, only to be outperformed by the Sunday of Thanksgiving last year. Capacity for the quarter was up 9.9% versus the second quarter of 2022, and our planes continue to fly full with load factors increasing from 85.5% in April to 86.4% in May and 89.1% in June, the second highest monthly load factor in our history.

Turning to unit revenues, changes are noisy on a year-over-year basis at down 2.9% given both volatile pricing and capacity in 2022. However, when compared to a more stable 2019, we saw improvement in unit revenues of 23% for the quarter, with June up 25%. We still expect July to produce the highest total revenue of any month in 2023, which is consistent with pre-COVID trends, but for the second straight year, June has supplanted July as the peak yield month for us.

Regarding product, strength in premium cabin revenues continue to support our revenue momentum. We launched the sale of exit row seats in mid-March, and I'm pleased to report sales have been strong right out of the gate. Including exit rows, first and premium class revenues were both up approximately 12% year-over-year, outpacing main cabin by 8 points. In the second quarter, 31% of total revenues came from premium class products, up from 22% in 2022 and up 7 points from 2019.

On the loyalty side, performance remains strong with bank cash remuneration up 15% versus the second quarter of 2022, outpacing our system revenue growth rate by 2x. As always, we continue to prioritize delivering value to our guests through our loyalty program, and we are proud to have been named the #1 best airline reward program for 2023 and 2024 from U.S. News earlier today.

Lastly, we are now selling 9 of our partners on alaskaair.com and anticipate bringing on our tenth partner this fall. Phase 1 is to sell and service main cabin tickets. But later this year, we will add the ability to sell premium cabins on our website, helping us to achieve our vision of providing our guests seamless ticketing capability on our portfolio of global partners with access to any major region of the world.

Now I'll turn to our outlook and forward-looking guidance. Demand remains very strong even as we've come off the peak of historically high fares, a trend we knew would happen at some point. Notwithstanding this evolution, yield is still meaningfully above 2019 levels on industry capacity that has now surpassed 2019 levels by an estimated 6% for the second half of 2023. For the third quarter, we expect revenues to be flat to up 3% on capacity that is up 10% to 13% versus 2022. This implies unit revenues down approximately 9% at the midpoint. Our revenue guide is based on the environment we see today with 67% of third quarter revenues on the books.

When comparing our Q3 revenue guide to our Q2 results, this implies a 6-point sequential deceleration in unit revenue performance. Of that 6 points, roughly half is directly related to the pricing environment, while the other half is a combination of domestic industry capacity growth tracking to be up 10% year-over-year, our stage length growth and holiday timing shifts.

As a primarily domestic leisure carrier, this summer presents a unique situation with the unprecedented surge in international demand, not dissimilar to the domestic surge last year. We believe pent-up international demand has had the effect of a larger pull from would-be domestic travelers than has historically been the case. Long-haul international seats of the West Coast are up 31% year-over-year this June. Our loyalty members alone in June, as evidenced by accrual and redemption activity, were filling the equivalent of 18 787s on a daily basis across our international partner network, up over 50% year-over-year, while our lounges experienced a 68% increase in visits from guests traveling internationally. While we believe this will ultimately normalize, there is a disproportionate impact on our realized domestic fares in the third quarter, which we estimate could impact our Q3 revenue performance by approximately 0.5% to 1%, which is reflected in our guide.

Close-in demand is another important dynamic to address. Having improved recently, the percentage of passengers booked and flown within month during Q2 surpassed both 2022 and 2019 levels. This is particularly significant when compared to 2019, given our stage length has increased 7%, where passengers skew to more advanced booking patterns and business volumes remain down 25%. Although currently not in our forecast, if this trend persists, this represents an additional 100 basis points of revenue upside to our current third quarter guide.

Lastly, as it pertains to managed business travel, we have not seen any meaningful change remaining around 75% recovered by volume with both California and the technology sector still accounting for the largest gap to full recovery. However, we have seen more return-to-office efforts at major tech companies and are incrementally more optimistic that we might finally break through the 75% recovered ceiling. Although we have not baked any of this into our guidance, we will continue to watch this closely as we move into the fall.

For the full year, our revenue guide remains unchanged at up 8% to 10% versus 2022, but on higher capacity growth of 11% to 13%. While our capacity is taking a step up in the third quarter and full year, in part due to strong operational performance, it is primarily driven by Alaska's gauge and stage growth as we benefit from the replacement of the Airbus fleet with larger, more efficient MAX aircraft. As a reminder, by September 30, we will have replaced all 72 Airbus aircraft at an average gauge of 150 seats with brand-new MAX 9s that have 28 more seats. The benefits of upgauging are clear in our June results as gauge has grown 7% year-over-year, yet our load factor was only down 0.4 of a point year-over-year from what was the highest load factor ever flown in our history.

At a system level, we have restored ASMs in the second half of the year to approximately 103% of 2019, but there are still areas within our network, including Portland and California that are not fully restored. The West Coast is still the least recovered geography across the industry, and we are focused on restoring our pre-pandemic network, especially, where we have opportunities to provide feed for international partners.

In a period of historically high demand and yields, the right economic decision has been to fly and maximize ASMs within our fleet and crew capabilities. That said, if we identify pockets of relative softening, we will adjust as needed to deploy our capacity thoughtfully.

While the industry continues to normalize and work towards a new, more predictable environment, we have confidence in our commercial plan. With business travel still below historical levels and the West Coast lease recovered, we believe there is more upside to come as we head towards 2024. We are focused on pursuing and implementing our longer-term strategic drivers of profitable growth, specifically, our partnership in oneworld and the West Coast International Alliance, our premium products and our loyalty program. Our value proposition is significant, our initiatives tangible and our product well suited to traveler needs post pandemic, positioning us well to continue to serve guests and build on our strong results going forward.

And with that, I'll pass it over to Shane.

Shane R. Tackett - Alaska Air Group, Inc. - CFO & Executive VP of Finance

Thanks, Andrew, and good morning, everyone. As both Ben and Andrew shared, we saw continued strong demand throughout the second quarter, carrying a record number of passengers, both to end the period and into the 4th of July holiday. Our teams have done an excellent job this summer delivering a safe, reliable operation in the midst of full flights and very busy airports.

Now that we've restored operation excellence, which we viewed as our first priority, we now look forward to added focus on driving consistent improvement to our unit cost profile. Ultimately, operational excellence leads to cost-efficient operations, and coupled together, they will allow us to continue to deliver strong relative financial results within the industry.

Turning to results, our balance sheet and liquidity positions remain healthy and a core strength of ours. Debt to cap finished the quarter at 48%, while our net debt-to-EBITDA remains below 1 turn and better than where it stood in second quarter 2019 at 0.9x. Debt payments were approximately \$50 million for the quarter and are expected to be \$100 million in the third quarter. With a strong demand backdrop and start of summer travel, we generated approximately \$600 million in cash flow from operations during the quarter. Total liquidity, inclusive of on-hand cash and undrawn lines of credit remains very healthy and within our target liquidity range at \$2.8 billion.

Also, our share repurchases for the year have reached approximately \$60 million year-to-date and our trailing 12-month return on invested capital reached nearly 12% this quarter.

Turning to costs and capacity results, as I noted, our operation has been running extremely well. For the second quarter, capacity was up 9.9% versus Q2 2022, above the high end of our guided range, which is primarily driven by a higher completion rate than we had originally planned. Our completion rate has been 99.7% over the last few months, and given this, we have higher completion for the balance of the year, resulting in slightly higher capacity forecasts for the third quarter, which we expect to be up 10% to 13% and for the full year, which we expect to now be up 11% to 13% versus 2022.

Moving to costs, our second quarter CASMex was up 2.4% year-over-year, within our guided range, albeit on higher incremental capacity. While we did not miss our range, we, of course, expect to be at midpoint or better when we outperform on capacity.

The drivers away from midpoint or better are predominantly not structural. They are relatively small misses against what we know were aggressive cost and productivity targets. To be clear, our cost profile continues to improve, both sequentially and year-on-year. And in comparison to the rest of the industry, we believe we have the best cost trends, especially given we are growing at a somewhat slower rate than many of our primary competitors.

Areas where we saw elevated costs relative to expectation remain related to running a solid operation, including staffing levels modestly higher than plan, and elevated overtime and premium pay. Ben and our leadership team have been clear with the company that operational excellence and consistency is the first priority. And having now established that, we will incrementally focus on working these cost areas down appropriately.

We also have slightly higher than forecasted crew costs associated with our transition out of the Airbus fleet. We assumed higher levels of attrition from the fleet and are, as expected, incurring significant training costs related to transitioning Airbus pilots to Boeing.

Turning to unit cost guidance, we expect third quarter CASMex to be flat to down 2%. For the full year, we still expect to see unit costs down 1% to 3% year-over-year. As a reminder, our CASMex guide includes profit sharing, and we anticipate that we may be the only airline that will achieve unit cost reductions year-over-year. And we will do this on less incremental capacity versus our peers.

Finally, fuel trended positively falling below our previously guided range and finishing at \$2.76 for the second quarter. Based on current trends, we expect fuel price per gallon to be \$2.70 to \$2.80 for the third quarter. While this offers a benefit compared to last year, fuel prices are still up approximately 30% above 2019.

To wrap up, it feels like we are finally getting back to normalized operations after over 3 years of unprecedented challenges. We have work to do and opportunity to improve further, but we are delivering results within our guided ranges. As Ben mentioned, we are still tracking to deliver our 9% to 12% adjusted pretax margin this year with visibility towards an EPS restored to 2019 levels at the midpoint of both higher fuel and structurally higher labor costs.

As I look forward, I think we have a very solid setup. We've got arguably the best absolute cost trends with further opportunity to drive unit costs down next year. We believe the West Coast is the least recovered region in the U.S. but also believe it will continue to recover, including business

travel, which will provide future revenue tailwinds. We believe that once pent-up international demand is run through, there will be a normalization in the international versus domestic demand mix, further providing pricing support in our network, and we have further opportunity to drive our commercial initiatives.

So even as we expect to compete for the industry's best margin again in Q3 and for the full year 2023, we know we also have the opportunity to further improve our margin performance in the years ahead.

And with that, let's go to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Jamie Baker from JPMorgan.

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

So the RASM guide in the second half is clearly disappointing. You mentioned that Seattle South or West Coast was the least recovered. If we parse your network into 4 buckets, Hawaii, Seattle North, Seattle South and then Seattle East. Could you rank order them in terms of year-on-year RASM change, looking forward, not the second quarter, related to the guide?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Jamie, Andrew, that's maybe a little complicated off the top. I think what I would say is there is a lot going on in our network, but essentially, we continue to see California improving, both our margins versus 2022 and 2019, but it's the least recovered, but it's getting stronger as far as the Pacific Northwest, that's where most of our growth has gone.

And again, we've seen really good unit revenue strength there. But I would say at the end of the day, as we've said in our prepared remarks, overall, we're coming off the high across the network, across the system from historically peak unit revenues. That said, our planes across the board are still extremely full.

And again, as we talked about, a lot of the things that we've got there in our guide haven't been fully baked in. And importantly, if you look at the recent results from the other big guys, essentially, they had a deceleration from Q2 to Q3 of 4 to 5 points, which they're anywhere up to half international, which is extremely strong, and we're only down decelerating 6 points. So on a relative basis, we feel really good about our performance.

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

Okay. And second, you spoke to 2024 ex-fuel CASM potentially declining. What level of capacity growth is required to get you into -- to push down ex-fuel CASM measurably next year?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Jamie, it's Shane. I think our -- we'd want to be in our sort of long-term target range of 4% to 8% to have line of sight to that. It's really early, obviously, in terms of thinking about capacity next year. But it's completely our intent to continue to drive it down and to see a year-over-year reduction in 2024.

Operator

And our next question comes from Andrew Didora from Bank of America Global Research.

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

So Ben, Andrew, just maybe want to ask you about what seems to be a little bit of a change in -- little change in strategy here basically exchanging your trading yield for more capacity. I know you explained it as a little bit more completion factor, but -- why is now the right time to do that given the domestic international share shift? And would you consider cutting capacity in the back half of the year if fares remain soft?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Andrew, yes, a couple of things. I just want to be clear on the capacity side and the 3-point increase from the guidance. None of this is new flying. It's been in our tapes for some time. And 50% of that is already sort of came in, in the first half of the year, and we're a little bit stale on the guide.

But we exceeded our completion rate and we've been very conservative. So half of that increased capacity is technically for the rest of the year. And again, it's all buried in completion rate, which has been extremely strong and also our Boeing and Airbus deliveries. We've firmed those up and we have -- excuse me, retirement of Airbus and Boeing deliveries, and we firm those up, and we have -- feel much better about the rest of the year.

So that's really what's going on in the capacity side. The other thing is 80% of our capacity growth in the back half of the year, it's all stage and gauge. It's very highly efficient. And with these high load factors and strong demand, we feel good about our position.

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Yes, Andrew, it's Ben. I think another factor is when you compare, where our capacity is compared to 2019, we're just getting back to 2019 levels of capacity. And then just to put another point on what Andrew just said, our departures are actually down 1.3%. So we feel like we're in the right place for capacity.

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

Got it. And then just my second question, just -- if I were to take the midpoints of your capacity and revenue outlooks for 3Q and the full year, 3Q RASM seems to be the trough this year with 4Q a couple of points better. What is driving your thought process on this? Is it that domestic international share shift or anything else you're seeing in your booking curves?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. Thanks for that. As we shared in the prepared remarks, there is the deceleration, about half of that is indeed to the core pricing, but there's also increasing capacity and our stage length and a little bit of a shift in holiday. But if you look to the fourth quarter, we're showing it accelerate just a little bit if you just do the math.

And again, we have a lower base in the fourth quarter last year. And we've tried to be conservative. And while we're not giving any pure guidance today on the fourth quarter, there are a couple of things like business travel and the abating of this international versus domestic demand that may actually come to fruition in the fourth quarter.

Operator

And our next question comes from Helane Becker from TD Cowen.

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

So Ben, I thought you were really optimistic and positive on both the quarter and the outlook, and yet your stock is down 12%. So obviously, people don't think it's that positive. And I know that sounds kind of obnoxious, but my question really has to do with capacity.

It seems that the pushback is too much capacity growth in a domestic market that's not really growing as rapidly with pressure on fares, a. and b., to Andrew's last point, the hope for a shift away from international to more domestic later this year. I'm not sure I would agree with that just because of the pent-up demand that exists for -- continues to exist for Europe and Asia. So just kind of wondering how you're thinking about the disconnect between what you're seeing and saying in the stock price?

Benito Minicucci - *Alaska Air Group, Inc. - President, CEO & Director*

Helane, look, it's a great question. Look, I just want to put things a little in perspective. We had a fantastic Q2 quarter with -- will likely be industry-leading pretax margins. We're still going to have a strong Q3. We're guiding to reiterate our 9% to 12% pretax margin for the fourth quarter. But I think demand, when you look at domestic demand, domestic demand is still strong.

And as you guys have done your calls with other airlines, you're seeing this massive surge in international travel, similar to what we saw domestically about a year ago. So our view is that's a great thing for the industry to have international come back, and we're putting a lot of our loyalty members on our partners' metal, which is a good thing. But we do see strengths still in the domestic market. And we do see this normalizing towards at the end of the year into 2024.

When it comes to capacity, as you know, airlines just can't switch -- put a switch on in terms of turning on capacity and turning it off. You kind of have to have a plan you have to execute. The question is -- the issue is we're executing extremely well from a completion rate perspective. And again, I am optimistic about our business, it is solid across every, every lever. And we're dealing with just a surge of international demand right now, which we think will normalize towards the end of the year. So that's how I'm looking at it, Helane.

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

Okay. That's very helpful. Just on the follow-up question on California. I've noticed that there have been some capacity shifts as people have shifted -- other airlines have shifted some capacity out of California, but you guys have shifted into some markets. Can you just talk about the thought process there?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Helane, I don't know if you're referring to San Francisco, Burbank or anything more general than that. But essentially, we're always looking at our network. We've -- we are leaning into Latin, Mexico, Costa Rica, that good stuff and we continue to round out and build out our California network, which, as I shared earlier, is still 25% down from 2019 levels.

But there's no major shift or changes there. And our recent market entry is a top 20 market out of San Francisco, and that was an area that we felt we needed to be in.

Operator

And our next question comes from Conor Cunningham from Melius Research.

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

On the full year capacity and the reiteration of the CASMex guide. I'm just trying to understand why there wasn't more leverage. Is there some sort of incremental cost bubble near term that you're going to see maybe a productivity offset come into fourth quarter. It seems within the guide, there's a pretty big step down as we exit the year. So just curious on the moving parts there?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Conor, it's Shane. No, there's no real call out in terms of the cost category that is off-trend or off expectation in terms of the go forward. I think I mentioned some of it in the script. Number one, we tend -- and I think you guys know this to be pretty aggressive with ourselves on cost and productivity. We are getting closer to our 2019 productivity. It's our goal to ultimately get as close as we can to it. But we're a little bit short of what we had wanted to be at this summer.

The good news is that those are all things we can control and that we will continue to work on as we get through the end of the year. We've had some other things just move around. The Airbus retirement moving up to several months pushed significantly more of the transition training cost into this year and into Q2 and also into Q3. And like we're carrying a significant amount of surplus pilots on the Airbus. We were really deliberate about trying to retain folks onto that aircraft. So we weren't doing a lot of training of new people into the Airbus and I think that program was successful. And we've got a lot of pilots who we just need to get through the school house and over to the Boeing.

So I'm feeling good about where we sit. Going forward, I think we need to do a little bit better job on executing aggressive cost targets. But to be clear, sequentially, we're getting better. I think we expect to also get better relative to Q3 and Q4. Year-over-year, we're better in both of those periods. I think we're set up well for next year. We'll lap our step-up in maintenance costs, which we talked about earlier in this year, the 900 ER engine deal. We'll have all of our Airbus transition costs materially in this year and not with us next year.

And we've got a stable operation, and we know that long term, high completion rate, high on-time performance operation, we can leverage into better cost performance. So yes, you guys, I know, will continue to pressure us on this. We're going to pressure ourselves and I feel good about how we're going to perform over the next several quarters on costs.

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

Okay. Maybe as a follow-up pressure push. On the training costs headwind, can you provide some context to how much that is. As we -- I mean I think that everyone understands that you guys got a pretty good cost plan going into next year. I'm just trying to make sure we have the magnitude of the moving parts, right, as we think about next year? Is it a noticeable amount within your full year guide, I guess, in '23, specifically?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Yes. I mean, just for the quarter in Q2, it was an extra \$3 million relative to what we would have anticipated. We're carrying as many as 75 extra captains on the aircraft right now relative to what we would normally need to fly 10 aircraft. So it's not insignificant. We've had to train -- and we'll get the number to you Conor offline. I just don't have it in my head.

Multiple hundreds, 300 or 400 pilots this year or more, 500 pilots this year from the Airbus to the Boeing. Those are not training events that we would normally have in the system. And those are training events that not only provide cost drag, but growth drag as well. So it should be a very significant change next year once we get through this.

Operator

And our next question comes from Brandon Oglenski from Barclays.

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

I guess, Ben, I just want to ask about volatility because, obviously, the stock is reacting today, and I know this is day-to-day. But you guys did look back on the first quarter and say, "Hey, look, off-peak, we wanted to manage something different and going forward, we will." But it looks like you're adding capacity in the back half and just not getting revenue for it. So is this just the case maybe you overearned in 2Q and you're kind of normalizing your earnings base in the back half of the year? Or what more can you talk to this?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Brandon, it's Shane. Maybe I'll start. I think it's fair to say, look, Q2 was very strong. I think every airline has beat their midpoint of their guidance. I think we did as well. We're excited that we were, I think, going to be at the top of the industry in terms of margins. So it is a really high base that we're comparing ourselves now going forward.

I think one thing we haven't mentioned yet, but we should is fares, while they're off of their unsustainable peaks of last year, they're still very high relative to 2019, and we're still filling planes up at those fare levels. So I think, yes, Q2 could prove to be a high watermark for the industry. But I don't -- I think that our business is healthy and strong, and we have a good setup as we move forward, both on the cost side and a lot of opportunity on the revenue front as we continue to see this region recover and business travel recover with it.

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

Appreciate that, Shane. And then Andrew, you did talk to half of the impacts from the sequential deterioration in RASM being pricing. But I think you also said like another 1/3 from industry capacity. Could you just expand upon that a little bit?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes, Brandon, basically characterized the 6 points, half of it being just core pricing coming down off the peaks and then 3 elements are remaining, which were essentially our own and industry capacity growth, our stage length growth, which is up quite significantly, and then also, there was a more of a minor shift in the 4th of July, but those made up the balance of the difference.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Brandon, this is Shane. I'll just unpack that for you because I think I know what you might be asking. We have a normal capacity growth to RASM reduction model that we sort of assume. It's pretty consistent over the years. What we're saying is the pricing reductions is slightly higher than that model would suggest. And that's what Andrew's attributing to coming off the peak pricing impact.

Operator

And our next question comes from Savi Syth from Raymond James.

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

Just a little bit, again, going back to the cost side. I was a little curious on what you're seeing from Boeing. And your confidence in being able to kind of exiting this year and then going into next year, being able to kind of deliver on that capacity. And if you look at -- if you could, Shane, just at a high level, again, what are the big chunks of kind of headwinds and tailwinds next year on the cost side?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Yes. Thanks, Savi. Boeing has been doing a phenomenal job for us this year. In fact, if we were to blame them for anything, it would be that they've given us all their planes on time and so we've added capacity to the schedule a little bit, which people are questioning today, but they've really been good delivering on schedule. I don't think we've had one aircraft come after it was scheduled to be in service. So they've continued to do a really good job.

We have a bunch of deliveries in December. December is always a month where things can slide around a week or 2. So there might be 1 or 2 units that end up in January of next year, but we're not concerned about that at all. I think they recovered very well from both the quality escape and the spirit sort of period that they went through recently.

So we're feeling good about the fleet plan going into next year. I think we're anxious for them to get the Dash or the MAX 10 certified. Whenever that happens, we don't know when it will, but we can't wait to fly that airplane and take a lot of those. But Boeing has been just really, really good this year in terms of getting back on plan for deliveries.

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

And just on the major buckets there...

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

I liked the first question. I'd forgot about the second one. Look, I think on the sort of tailwind side, I mentioned a couple of these, we have \$100 million of cost step-up on the 900 ER engine deal this year, that will be fully lapped. Look, the vast majority of contract costs, we are currently lapping.

We do have deals that we need to get done with our flight attendants and our mechanics which we're anxious to do and we're actively obviously working on those. I would expect and I hope that some of those costs are captured this year, but there will be some additional lapping to do of those deals next year. I'm not going to talk about sort of amounts.

And then the Airbus transition costs will be fully behind us, which will be another really good positive tailwind. And then like I said, it's with a -- our job now is to take and translate a really strong operation that is performing well and making sure that we're doing that at the most efficient cost structure possible. So those are lots of little opportunities throughout the company, but we're going to be really focused on leaning out the cost structure next year because of our operational excellence.

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

Helpful. And can I clarify just quickly on those kind of fare softness. When did you start to see that? I think the other kind of question that investors are going to have is, obviously, is this the start of further declines? Or is there something a new level that you've seen stabilize? Just a little bit more on that when you saw that fare and then what you're seeing today?

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Savi, as you know, our quarters build up the quarters beforehand. But I think as we were coming into the summer a little while ago, we started to see in the third quarter a couple of months ago, just starting to see that they might have been peaked and coming down a little bit off there.

Again, I don't know if I'd say use the term softness. I do think it's that finding that fine balance between the demand and supply. But again, as -- the streets been reporting as well over the last 6 to 8 weeks, this been coming off of the high and we saw that a couple of months ago.

Benito Minicucci - Alaska Air Group, Inc. - President, CEO & Director

And Savi, remember, demand is still very strong on the domestic side. Our load factors were some of the highest we've seen. And it's really due to the surge in international. And I think if you really look at it, international is going to be strong from maybe June through September, October. But as kids get back to school, and things start to normalize, like I do think this thing is going to find its equilibrium. So I just wanted to give just a little more context on how we're seeing it.

Operator

And our next question comes from Catherine O'Brien from Goldman Sachs.

Catherine Maureen O'Brien - Goldman Sachs Group, Inc., Research Division - Equity Analyst

I know we spoke a little bit about this last quarter, and you touched on the prepared remarks Shane, but unit costs coming in at the midpoint on higher than planned capacity is not traditional Alaska performance, I guess. Do you expect to be able to squeeze some of those labor costs tied to shoring up operations as we exit the year? Or is that really more of a 2024 opportunity?

Shane R. Tackett - Alaska Air Group, Inc. - CFO & Executive VP of Finance

Yes. Thanks, Catie. It's probably more of a 2024, you sort of need the volumes to be there. And even though Q4 capacity is growing year-over-year, it's still down sequentially from Q2 and Q3. Not that we won't be focused on it. But the other thing, we have to get through this full Airbus transition and all of the pilot training.

One other potential tailwind for us next year, I didn't speak too much about, but we will be bringing on a preferential bidding system with our pilots sort of early-ish in the year, maybe April, it will take us a few months to get our feet under ourselves there, but that should also be marginally helpful on the -- on just the cost efficiency and productivity front.

Catherine Maureen O'Brien - Goldman Sachs Group, Inc., Research Division - Equity Analyst

Okay. That's great. And then, Andrew, you gave some stats on loyalty members flying on partners, uptick in international travelers going to your clubs. How does all that -- how does Alaska benefit from that? Does that hit your P&L? How do we think about that? I mean, obviously, you guys are primarily domestic carrier. But just wondering if there's any piece of the business that benefits from this international shift?

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Yes. Thanks, Catie. Actually, it's extremely exciting for us. It shows that we have our members that our global loyalty program really works. They're using the benefits and more importantly, as we move more and more partners to sell directly on alaskaair.com it just really opens up the utility that we can provide for our members that you really can fly globally with Alaska Airlines. So it's actually proving out the thesis, and I'm very excited as we move through the rest of the year.

Operator

And our next question comes from Mike Linenberg from Deutsche Bank.

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

Shane, I want to get back to your point on the flight attendants mechanics deals yet to be done. Have you considered accruing for those agreements? And the reason I ask is, there was a time where actually all the airlines used to accrue for labor deals and then I think we got to the point where it was just Southwest. And now we're seeing United accrue for their pilot deals. What's your thinking about that the philosophy? Does that make sense? And why not start it now? And then I have one more.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Yes. Thanks, Mike. We haven't considered accruing -- we're cognizant that some others have done that. I think the levels that those contracts represented that kind of made sense, but it's never -- since I've been here, been something that we've done. And I think it really just goes to the uncertainty around timing and we like to keep those discussions between ourselves and the union leaders at the property and not really be talking about what the economic impacts could be, which -- other companies have been a little bit more willing to talk about that in the open. We think it's a better approach to keep all that stuff between the parties and then once we're done, let folks know what we did.

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

Okay. Makes sense. And then just my second question to Andrew, and I realize this is more of a later this year, early next year, but you do have some pretty meaningful route changes, seasonal changes. And I know this goes back to a few quarters ago, maybe a quarter or 2 ago where you sort of came out and said we have to run a better airline or from a margin perspective in the winter in our -- what is historically our seasonally weakest time frame.

As I think about later this year, early next year, it does seem like a good portion of your ASMs will be new routes. And it feels like it's been some time, maybe since probably the Virgin acquisition where you will have that much of your capacity in new markets and I don't know, correct me if I'm wrong, anything that you could sort of shout out, since it's still early on things that you're sort of planning to do and maybe would address my question about how much of it is new flying versus historical. I feel like there's a few questions in there, so I'll drop it.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes, don't worry. Mike, well, I'm glad you asked because it's actually a really important question and point. Our schedules will start to reflect and are being reflected, but we've moved about 9 points of our capacity around in the first quarter. We've also got extremely laser-focused on the makeup of the first quarter, which is really 3 distinct seasons for us coming off of the Christmas and the holidays, then a very difficult period and then, of course, you move into March and the spring.

You've seen a number of new markets from us. Those are obviously reallocations. You see us leaning hard into Latin. We're trying some things like Mexico from Las Vegas is unserved, Nassau and all of those things. But honestly, the bigger impact on our capacity is just reallocating across our network, and that's sort of the 9 points of which some of these new markets are part of, but we're getting more disciplined, how much we're flying to New York City during the depths of winter, those types of things.

Operator

And our next question comes from Duane Pfennigwerth from Evercore.

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

Just firstly, anything in the 3Q comp from last year, you could call out, for example, was there any travel credit breakage above trend that you could quantify?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Duane, it's Shane. I don't think there's anything sort of materially worth calling out on the 3Q comp basis, certainly not on the breakage stuff. We -- I think we had already gotten through most of that prior.

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. The only thing in the third quarter last year, obviously, coming off the back of some operational challenges in the pilot pipeline, we had some closer in pull downs that impacted summer and specifically California in a large way, but other than that.

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

And you mentioned some holiday shifts. Could you just elaborate on that?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes, that's just the minor, the 4th of July fell on a Friday. And so we think -- which was June this year versus July last year. So there's a little bit of movement into the month of June. I think just interestingly, as we noted, 2 years running now, the unit revenue in June is our highest of the year, and that seems to be continuing.

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

Yes. And then just I think another comment you made, which was interesting on -- in the quarter -- for the quarter bookings. Could you put a finer point on that as it relates to the booking curve? Are these within a week, within 30 days? And does -- I know you're not baking that trend continuing, but does that imply that you now enter a quarter with lower visibility than you historically had?

Andrew R. Harrison - *Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP*

Yes. I think -- I mean, kudos to the revenue management team. I think when you look at what you're referring to is the amount of bookings we take in the month to fly in the month. When you look at ourself too soon as last year, we've had really good improvements this year on Hawaii, Mid-Con, Inter California, even the TransCon Southeast. And essentially, what we're seeing is we have availability and the demand is there, and we're filling the airplanes, and you see that both in the higher load factor. But interestingly, even with business demand down, especially for June, we saw more close-in within than 2019.

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

Sorry, you're not baking that into your guidance, but have you seen any change in trend as it relates to this close-in showing up?

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

I will just -- I can sit here that day on the 25th of July and tell you that I'm continuing to see that close-in strength this month.

Operator

And our next question comes from Stephen Trent from Citi.

Stephen Trent - Citigroup Inc., Research Division - Director

Just one, and I know it does not directly pertain to you. But considering that your partner, American Airlines, is going to do the unwind of the Northeast alliance, did that in any way kind of lead you guys to pivot on your eastbound strategy?

Nathaniel Pieper - Alaska Airlines, Inc. - SVP of Fleet, Finance and Alliances

Stephen, it's Nat Pieper. A couple of things just to distinguish our partnership with American a), we're pleased with it; and b), reviewed and approved by the DOT in 2020. And the good thing about that partnership is it's very much a traditional airline alliance. It links -- we link our complementary networks with Codeshare. We offer reciprocal loyalty benefits that have really resonated with guests. So we see plentiful opportunities with American in continuing to link our networks in places of weakness for each of us and offer more utility for our joint customers going forward.

Stephen Trent - Citigroup Inc., Research Division - Director

Okay. That's super helpful. I appreciate the color. And just one very quick follow-up, which I know is also not directly related to you guys, but -- you mentioned some potential perking up of the tech industry travel. Do you have any sort of specific signposts there? Like I think I had heard something about Microsoft turning on corporate travel again or any sort of return to office initiatives you're hearing from your tech partners, or customers rather?

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Stephen, we did make the comment that we might break through the 75% ceiling as we move forward. Just a couple of interesting data points. But 10 of our top 20 corporate accounts are actually recovered revenues and over 2019 levels right now. But we are seeing high variability within those accounts. We are still seeing some high-tech companies very low, not recovered, but we're also seeing some high-tech covered companies that actually are fully recovered.

So I think what I would say to you is that we're starting to see a thawing, it's not a all the techs are down now, we're seeing some really start to perk up. And I think this why gives us a little bit of hope that there might be some green shoots here as we move through the rest of the year.

Operator

And our next question comes from Dan McKenzie from Seaport Global.

Daniel J. McKenzie - Seaport Research Partners - Research Analyst

I guess a couple of questions here. Andrew, I'm wondering if there's been a change in the composition of revenue by advanced purchase bucket. So more discounting further out, firmer pricing closer in and, at least, in kind of what you referenced to your close-in strength today. And I'm just wondering if the current forecast for the third quarter is predicated on strong close-in demand throughout the quarter.

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Yes. Thanks, Dan. You're spot on, like the structured fares are what they are. But what we are seeing in the sale fares, they're sort of a little down than they were this time last year as in lower. But the close-in 0 to 13-day fares are actually up than they were last year. So overall, you're seeing that softness on the sale fare side. And we not baked into our forecast continued close-in booking strength.

Daniel J. McKenzie - Seaport Research Partners - Research Analyst

Yes. Perfect. Okay. And then going back to the commentary on business travel potentially coming back later this year and next. I know it's not in the outlook for this year. But are there conversations with corporate travel managers to lead you believe it's -- it could come back later this year? Or is it really just a view that California weakness has to reverse at some point?

Andrew R. Harrison - Alaska Airlines, Inc. - Chief Revenue Officer, Chief Commercial Officer & Executive VP

Yes. A lot of people say they're going to do things and then what they actually do may be different. I think what we're just looking at is across our corporates, who's doing what. And I do think there is a thawing from what I see and an upward momentum in a number of these.

And so again, while I -- we need to make sure, obviously, and looking at the business fares and they're holding up quite well. It just depends on as they move through, and I've always had the philosophy that a lot of this is driven by budgeting by our good friends, the CFOs in these organizations. And you really are not going to see a material change in rebudgeting until 2024. So that's just what I see.

Benito Minicucci - Alaska Air Group, Inc. - President, CEO & Director

And Dan, it's Ben. You got to remember, on the West Coast, we have some of the biggest companies in the world headquartered here on the West Coast, both in Seattle and in the Bay Area. So it is a more difficult time for them, but they're going to come out of this. Again, we're optimistic they'll come out of it towards the latter part of the year and into next year. And it is dry powder for us, there's going to be tailwinds for us and these are the biggest companies world, and there should be a lot of upside.

Operator

And our next question comes from Chris Stathoulopoulos from Susquehanna Group.

Christopher Nicholas Stathoulopoulos - Susquehanna Financial Group, LLLP, Research Division - Associate

So with the capacity raise, it's entirely on completion rate, but could you remind us to think about the mix of frequency gauge and stage that you outlined last year, how this -- how 2023 is shaping up?

And then also, you spoke about in your prepared remarks on prioritizing reliability. Normally, I would think if you're trying to prioritize that or build in buffer to your capacity that the guide would have come lower. So I just want to better understand here the moving pieces here or the composition of capacity as we think about the back half of the year.

Shane R. Tackett - Alaska Air Group, Inc. - CFO & Executive VP of Finance

Chris, it's Shane. We set a 70% of the -- 90% of the sorry, 70% of the growth, I think, was stage engaged, like 3 quarters. And I think that's what you saw in the second quarter. I think that was reflected in Andrew's commentary. And that will start to abate as we get towards the end of the year and lap some of that impact when we started aggressively getting out of the Airbus flying.

Good question on reliability being a priority? How do you do that and then guide up, not down. What I can tell you is with the planes and the people that we had for this year, we could have flown even more than we are now telling you we're going to fly. And so -- we put a significant amount of buffer into this year. I think I talked about it last quarter that we were outperforming many of those assumptions, both on the delivery side from Boeing, our own completion rate and so -- we're just sort of squaring up now with the fact that we've been overperforming on a lot of those assumptions. But -- we thought it was prudent this year given the last couple of years to assume a much lower completion rate than normal. And we've outperformed it, which is a really good story, and now we just need to kind of normalize the company around the completion rate we are achieving today.

Christopher Nicholas Stathoulopoulos - *Susquehanna Financial Group, LLLP, Research Division - Associate*

Okay. And then on 2024, I realize it's still early. It sounds like you're suggesting that we could see unit costs down on a kind of a 6% or mid-single-digit-ish type growth here. But -- and you do have the benefit of gauge here, of course, there is this slight miss with respect to forecasting.

But if we think about RASM for next year and the ability to grow in excess of that, and sort of the moving pieces here as we think about the debate, this pool of international travelers that are being -- for the pool of travelers here that are being consumed by international, certainly a debate on the duration of how long that lasts?

And there is concern out there that the domestic capacity is going to continue to grow. So -- is it fair to think that kind of holding load factors here constant for this year that you can grow your RASM in excess of CASM next year?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & Executive VP of Finance*

Chris, I think we are pretty -- we have a pretty standard practice not to speak about next year on these types of calls. Although I totally understand and appreciate the question. Look, it's a little too far forward for us to predict what the economic environment is going to be, what everybody's capacity is going to be.

I think generally, across the industry, you've seen capacity guides come in from where they were originally sort of talking about. So I think there's a lot of open questions on what people are going to fly next year. I would point to the fact that Andrew just spoke about a really -- a focus on Q1 and sort of reconcentrating the network, so we've got opportunity to do better in Q1.

And then we've got these other tailwinds with this region of the country improving, with international demand normalizing at some point. And yes, it could be a little longer than we're thinking, but it may not be, and business travel recovering plus a lot more that we can push on the commercial initiatives. So there are some other things other than just peer growth that should drive the top line of the company next year. And obviously, we're going to be talking to you guys a lot more about that in the next couple of calls.

All right, everybody. So our time is up. So thank you so much for dialing in, and we'll talk to you next quarter.

Operator

This concludes today's conference call. Thank you for attending.

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