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ALK.N - Q2 2020 Alaska Air Group Inc Earnings Call

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OVERVIEW:

Co. reported 2Q20 YoverY revenue decline of 82% and GAAP net loss of $214m.

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CORPORATE PARTICIPANTS

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

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

Bradley D. Tilden *Alaska Air Group, Inc. - Chairman, CEO & President*

Christopher Michael Berry *Alaska Air Group, Inc. - VP of Finance & Controller*

Diana Birkett Rakow *Alaska Air Group, Inc. - VP of External Relations*

Emily Halverson *Alaska Air Group, Inc. - IR*

Kyle B. Levine *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, Senior VP of Legal, General Counsel and Corporate Secretary*

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

Shane R. Tackett *Alaska Air Group, Inc. - CFO & EVP of finance*

CONFERENCE CALL PARTICIPANTS

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

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

Darryl J. John Genovesi *Vertical Research Partners, LLC - Principal*

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

Helane R. Becker *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Hunter Kent Keay *Wolfe Research, LLC - MD and Senior Analyst of Passenger Airlines, Aerospace & Defense*

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

Joseph William DeNardi *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

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

Myles Alexander Walton *UBS Investment Bank, Research Division - MD & Senior Analyst*

Savanthi Nipunika Syth *Raymond James Ltd., Research Division - Research Analyst*

PRESENTATION

Operator

Good morning. My name is Erica, and I will be your conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group second quarter earnings release conference call. Today's call is being recorded and will be available for future playback at alaskaair.com. (Operator Instructions) Thank you.

I would now like to turn the call over to Alaska Air Group's Director, Investor Relations, Emily Halverson.

Emily Halverson - *Alaska Air Group, Inc. - IR*

Thank you, Erica. Good morning, and thank you for joining us for our second quarter 2020 earnings call. On today's call, you'll hear updates from Brad, Ben and Shane. Several other members of our management team are also on the line to answer your questions during the Q&A portion of the call.

The global health and economic crises continue to significantly impact our business and outlook. This morning, Alaska Air Group reported a second quarter GAAP net loss of $214 million. Excluding special items and mark-to-market adjustments, Air Group reported an adjusted net loss of $439 million. Special items this quarter include approximately $69 million of lease return charges that were triggered as a result of certain aircraft being permanently parked and a $362 million benefit related to the CARES Act payroll support program wage offset.

As a reminder, our comments today will include forward-looking statements regarding future performance, which may differ materially from our actual results. Information on risk factors that could affect our business can be found in our SEC filings.

On today's call, we'll 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.

And now I'll turn it over to Brad for his opening remarks.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Thanks, Emily, and good morning, everybody.

As you all know, we're now nearly 5 months into the deepest and most uncertain downturn in aviation history. While we've weathered many crises before, this global health pandemic and economic devastation are unlike any the industry has faced before. Here at Alaska, we're focused on two priorities: first, keeping our employees and guests healthy and safe; and second, ensuring our airline is here to support and serve them in the future. I'm very confident that we're taking the right steps to get us through the crisis and to ensure our long-term success.

In the second quarter, our leaders and frontline employees took dramatic action to reduce our capacity, to significantly lower our cost trajectory, to fortify our liquidity and to moderate our cash burn rate. The men and women of Alaska and Horizon have always been at their best in the face of adversity, and this could not be more true today. Here are a few examples of their efforts.

Our health and safety team led by Max Tidwell have led the charge in ensuring the health and safety of our guests. They've partnered with infectious disease experts from the University of Washington and other medical advisers to add layers of safety throughout the travel journey that build our guest confidence in flying. Ben will touch on these measures in a moment, and many of these are also highlighted in our press release.

Our crews and frontline workers have continued to provide our guests with remarkable care. Scaling down our operation, revising schedules and changing policies have introduced a great deal of change and complexity to our operation. Our people have handled this complexity with poise and grace, educating our guests about the in-airport and onboard policy changes and providing them the best and safest experience possible.

In the back office, our alliance teams and many others have continued to lay important groundwork for our future by moving our partnerships with American and oneworld forward. We're pleased to announce that we've received our formal invitation to join the oneworld alliance. And we challenge our teams to accelerate their behind-the-scenes efforts to push for our entrance by the end of the year. This is admittedly an aggressive goal.

And our finance and legal teams have worked with dedication to preserve and enhance our financial strength. In July, the team secured new EETC debt financing of nearly $1.2 billion, increasing our already strong liquidity position to $3.7 billion today. We entered this crisis with a strong balance sheet, and this liquidity infusion gives us even more staying power.

As Emily mentioned, we reported a second quarter adjusted net loss of $439 million, which excludes the benefit of CARES Act payroll support program. These results came while flying at capacity levels that were 75% below the prior year. This is a sobering loss. It's the largest quarterly loss in our history, and it's obviously not a sustainable result.

Our total revenues were down 82% for the quarter. And as bad as this number is, we believe it will be significantly better than the industry, which is a testament to our route structure and our low fares. Our adjusted operating expenses were down 47% for the quarter. And excluding PSP wage offsets, our wages and related costs were down 20%.

In the second quarter, we were among the fastest in the industry to bring our cash burn rate down. During the month of June, our absolute cash burn rate of $4 million per day was best in the industry on a size-adjusted basis. We expect our July cash burn rate to be up in part due to slowing ticket sales.

We're fully focused on getting our cash burn rate to zero. As you know, it's our goal to reach this objective by year-end, and achieving this goal will require two things: one, it will require us to do everything possible to manage costs and to help our customers know that they are safe flying with us; and two, it will require a more positive national backdrop with respect to the virus.

The news of late has been negative, with cases up, return-to-office schedules delayed, quarantines extended and schools announcing remote learning for the fall. We take great pride in controlling everything that is within our control. We will continue to do this, and I am very confident that Alaska will reach cash breakeven at or near the front of the pack with respect to our airline competitors.

Once we get beyond cash breakeven, we have confidence that our low-fare, low-cost structure and our strong network footprint will continue to be a source of strength, but the reality we likely face is that a recovery to 2019 levels will take at least 2 years.

Flexibility is essential in this environment. But given what we know today, we are planning for our business to be smaller for the foreseeable future. Ben will share more details in a moment, but our current plans are to be 35% smaller than last year in October and then building gradually to 20% smaller than 2019 levels by the summer of 2021.

We've made some difficult changes to reduce management positions, and we're working on programs now for our frontline employees. We've made significant progress already, and I'm optimistic that we'll continue to reduce the number of furloughs required through early-out programs, leaves of absence and incentive leaves. Ben and Shane will talk more about these in a moment.

To be clear, our employees did nothing to cause or contribute to the economic environment that has led us to make these challenging decisions, and they've given everything they've got to push Alaska and Horizon forward. These 2 facts make these decisions incredibly difficult.

We look forward to a day when we return to growing our airline. For today, we're focused on structuring our organization for our current reality, and this means adjusting our fleet size and our employee base. While this is a necessary step, I know that everyone here has the resolve to set a strong new foundation from which we can and will build our airline back to the size and growth trajectory we had prior to the crisis.

Before I pass this over to Ben, I want to recognize the heavy weight that many people in our country, including many of our employees, are carrying in these trying times. On top of the tragedy of the coronavirus, our nation is grappling with long-standing and deeply rooted racial injustice. We all have a responsibility to do better, and I want the black employees at Alaska and Horizon to know that this is a responsibility that those of us in leadership embrace. We stand for helping one another, and we stand for being good to one another. We are committed to listen, to learn and to do everything we can to effect positive and lasting changes in our company, in our communities and in our country.

And with that, I'll turn this over to Ben.

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

Thanks, Brad, and good morning, everyone.

Since this crisis began, our leadership team has been focused on creating plans for whatever scenario we may encounter, to candidly communicate those plans with our people and then to execute to the best of our abilities. Before updating you on how we're doing that, I'd like to provide some context for what we're seeing in the current environment.

By several measures, it is clear that the low point in this down cycle was in April. And we have now begun the slow, likely uneven, climb to recovery. April load factors were 16% as passenger counts had bottomed early in the month at only 4% of normal levels. Flight searches and new bookings hit a low point the following week, demonstrating confidence in future travel was also eroding.

Load factors then improved to 52% for June due to both returning passenger demand and actions we took to rightsize our capacity. Passenger counts increased to an average of 30,000 per day or 20% of normal, and flight searches at alaskaair.com rebounded to better than 50% of normal. These developments came as markets along the West Coast and the Southwest, including Texas, Phoenix and Las Vegas, moved to reopen and people's confidence in flying grew, driving leisure demand back to approximately 50% of normal levels.

We expect July load factors to show further improvement to approximately 55% on a sequential 5-point increase in capacity from June. But as Brad mentioned, we've seen some of these upward trends stall more recently as many of the geographies where we fly have experienced an increase in case levels, which paused many of the local reopening plans.

Demand is not something we can fully control, but we are doing our best to earn guest confidence and create the right environment for an eventual strong return in demand. Today, we recognize that customers fall into 1 of 3 buckets: those who will travel, those who might travel and those who won't travel. By delivering best-in-class health and safety policies and clear communications, we're connecting with those who will and those who might, providing them confidence that flying is safe. Even those who won't travel today have the potential to say they might travel tomorrow, and we believe we must be earning their trust as well.

Sangita Woerner's team has done a fantastic job implementing the program we call Next-Level Care, offering layers of safety through every single stage of travel and helping our guests build confidence for flying. Our safety measures include: making the preflight experience as contactless as possible and adding a health agreement during check-in; requiring masks for both guests and employees and empowering our crews to enforce the policy with the ability to issue a formal warning to any guest who refuses to do so; using the latest air filtration technology and hospital-grade filters to remove particulates and fully recycle air in the cabin every 2 to 3 minutes; exceeding CDC cleaning guidelines and using high-grade disinfectants to reduce the risk of transmissions on board; and keeping middle seats open through September 30, preserving our guests' ability to create personal distance while flying.

In our Alaska Listens survey, we've surveyed thousands of guests, and what they care most about are consistent mask policies, the blocking of middle seats and clean airplanes. 80% of those surveyed also reported that our Next-Level Care measures are working, and they feel strongly that we've created a healthy and safe environment for flying.

Alaska is also a strong advocate for temperature screening, and we are actively lobbying for screening to be implemented at airports by TSA. Collectively, we believe these actions we're taking will lay the groundwork for guests to confidently return to flying when they are ready.

Shifting now to our longer-term plans. We are committed to doing whatever is necessary to improve our competitive position and set the stage for future growth. Our top financial priority remains improving our cash burn rate and progressing towards our goal to achieve cash breakeven by year-end. To put this in context, I'll share some of our planning assumptions.

When we spoke with you last quarter, we knew very little about the crisis we are in today. The future is still largely uncertain and volatile, but the second quarter provided some key insights that help refine our thinking. Today, we are planning for Q3 capacity to be down by approximately 50%, and Q4 will be down by approximately 35%. At these capacity levels, we are also making a planning assumption that cash bookings will recover to 40% to 60% of normal by December.

This is not guidance, but demonstrates the parameters that we are operating within as we work to restructure our company. We believe these are reasonable planning assumptions for a few reasons. First, in June, we saw that traveler confidence and psychological safety are strongly connected. As destinations moved to reopen and health concerns began to subside, leisure demand returned quickly. This tells us that the desire to travel is there, just below the surface. Unlocking this potential requires ongoing societal progress and cooperation through behaviors like mask-wearing, better, faster and more reliable testing methods and improved treatments like a vaccine. We believe this progress will be made, even if slowly. Together, these factors would support continued leisure recovery.

Second, we're in the midst of the biggest demand contraction in the history of our industry. As we all know, there are far too many seats flying today for the demand that currently exists. Adding capacity back in a disciplined manner is important for the health of the industry and is critical to our company's cash breakeven goals.

Planning for a business that will be 35% smaller in the fourth quarter has implications for our operation and for our people. We have been clear with our employees that no one has a crystal ball to the post-COVID environment, and we will adjust course on capacity if our assumptions don't materialize. Whatever demand and revenue scenario we face, maintaining the strong liquidity position we have built is paramount, and our goal to achieve cash burn breakeven is a primary factor in the scenario plans we're putting together. Shane will share those details in a moment.

The strong showing from teams across the organization in the second quarter gives me confidence that we are prepared to manage the change and challenges we're facing. I am so grateful for our dedicated and talented people, and I know we will emerge from this crisis stronger than we came in.

With that, I will pass it to Shane.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Thanks, Ben, and hi, everyone.

Last quarter, we spoke to you about the factors we were focused on as we were beginning to manage Alaska through the initial shock of the COVID-19 crisis, including building our liquidity and aggressively managing our cost profile to preserve cash. Today, I'll provide an update on both areas as well as share initial thoughts on restructuring Alaska for the future.

On the liquidity front, we began 2020 with $1.5 billion in cash and marketable securities. Since March, we have added over $3 billion to that liquidity from: a $400 million draw on existing credit lines; $425 million from a 1-year loan in March; $163 million in new financing secured by aircraft; approximately $1 billion in payroll support via the CARES Act; and in July, we added $1.2 billion of cash through a EETC transaction.

Accumulating this level of liquidity in about 90 days' time is a superb achievement with credit due to our teams in treasury, finance and legal. The EETC is a new addition to our capital structure, and the team was superb in telling Alaska's story, attracting new investors and closing the $1.2 billion raise at reasonable rates.

I would add that while we moved quickly, we also had clear objectives we applied to guide our thinking about how to initially add liquidity during this crisis, which were: one, retaining strategic and financial flexibility; two, achieving a low cost of financing; three, maximizing cash yield from our collateral; and four, avoiding dilution of our equity base.

Our current financing mix nicely balances these objectives and leaves room for us to take further action if we need to. Today, we have $3.7 billion of cash on hand. We have $1.1 billion of unencumbered aircraft and non-aircraft collateral, and we also have our Mileage Plan assets available to use as collateral for future financing.

In the immediate term, given the uncertainty going forward, we do intend to continue to evaluate and pursue smart ways to add liquidity. We are in ongoing discussions with the United States Treasury for participation in the CARES Act loan program, which could provide an additional $1.1 billion in financing, utilizing our Mileage Plan assets as collateral. In July, we signed a nonbinding LOI with Treasury and anticipate final terms would be reached over the next 8 weeks. In parallel to the ongoing discussions with Treasury, we are evaluating other avenues of collateralizing Mileage Plan and other assets as well.

In addition to raising capital, the most important goal we have is to aggressively manage our cash burn rate. As mentioned, we do believe we were successful this past quarter in managing cash burn down at the quickest rate in the industry. This progress is a testament to Alaska's low-cost culture and the commitment of employees throughout our organization. In fact, in the second quarter, our adjusted operating expenses reduced by 47% on 75% less capacity. We typically view our cost as 40% variable in the near term, so to achieve a 47% reduction is a good result.

Regarding the cash burn rate, ours declined from over $400 million per month run rate exiting March to $120 million in June. As a reminder, we define cash burn as all operating cash receipts or cash that will turn into revenue, plus investment earnings, offset by all cash expenditures, including debt service and CapEx. We exclude financing raises or payroll support funding from this metric.

The improvement between March and June was driven by: improved bookings with stabilized cancellations; payroll savings of $45 million through the use of voluntary leaves, reducing management schedules and flexing crews down to contractual minimums; variable cost removal on reduced capacity; and the immediate suspension of discretionary and reduction of overhead spend.

July's cash burn, however, will be higher than June's driven by the slowing of forward ticket sales and the variable cost of incremental flying in the month. As Ben mentioned, our planning assumption today is for capacity to be down 35% in Q4, and we are planning for cash booking scenarios of down 40% to down 60%.

I want to expand on what that will mean for our cash burn goals, our people and our cost structure. To achieve cash breakeven by year-end while operating at levels 35% below 2019, we must reduce the size of our workforce. Today, we have approximately 23,000 employees, and we would likely need as many as 7,000 fewer active in the fourth quarter. Our goal is to mitigate to the greatest degree possible involuntary furloughs. As of today, over 30% of our employees are on voluntary leaves of absence, and we will continue to offer that program for the remainder of the year.

In July, we initiated early-out programs for all of our frontline workers and offered incentive leaves to pilots. While we will need to send out WARN notices on August 1 to potentially impacted employees, these mitigation efforts will reduce the number of involuntary furloughs that we expect to face in the future. Also, we have made the decision to reduce our management positions by 300 or 15% effective October 1. These are in addition to prior reductions of about 200 over the past couple of years. It goes without saying these decisions have regrettable and meaningful impacts on employees who invested their careers here. While extraordinarily difficult, these actions are necessary given the realities of our business going forward.

Beyond these immediate decisions impacting our payroll, we are also finalizing our plans to repair our cost structure and to ensure our ability to reach cash breakeven even in a severely depressed revenue environment. It is our intent to ultimately return Alaska to pre-COVID CASMex levels even if we are a smaller company on a sustained basis. To begin that effort, we are targeting to achieve structural cost reductions that would hit a $250 million savings run rate exiting the year. We'll have more to say on future calls on specifics of our restructuring plan.

As we turn to questions, I would close by saying that while all of this is easy to read off of my script, the truth is these things are very hard to do because they impact people. We are truly drawing lessons from our past where tough but balanced decisions were made by those management teams, which then put Alaska on a course to achieve all it has the past 15 years. And that mindset hasn't changed. We have to run a good business in order to have the future we want for our people.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Joseph DeNardi with Stifel.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

Maybe Shane or Ben, can you just talk about maybe some of the conversations you're having with your corporate customers? You talked about maybe the kind of the 3 buckets of your customers. And can you maybe speak to kind of the confidence you have at maybe the pace at which corporate returns and maybe how much does not return? And I know it's a difficult question, but maybe just kind of the framework you're using to approach that.

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

Thanks, Joe. I'm going to let Andrew. Andrew's been doing some work on that, so Andrew can provide some color.

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

Joe, thanks for your question. Yes, we're obviously talking about corporate customers weekly. We're seeing what I believe the whole industry is seeing, is that the corporate travel is massively down, over 90%. A big part of what the corporate accounts are dealing with is this concept of duty of care. And so with the extension of closing of office spaces, right now, we're not really seeing any thawing in the business demand. And so as Shane has been discussing, we are just going to be structuring our business in a way for a more prolonged comeback of business. That said, we've always excelled on the leisure side, and that we continue to expect to occur.

Joseph William DeNardi - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Airline Analyst*

And then, Shane, just on the loyalty program, if you use it as collateral for the loan package from Treasury, how much additional, I guess, financing capacity do you think exists against it?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. Thanks, Joe. I appreciate the question. So as you know, and I think this is one issue we are running into with the CARES loan program with Treasury. They're capped in how much that they can actually allow us to finance with that program. And we believe that they're capped at a rate that's well below the total value of Mileage Plan. And so it was our intent to pursue getting additional financing out in the public markets.

Recently, we've been presented with terms that would limit our ability to do that, and that wasn't something we expected to be part of the terms with Treasury 45 days ago. So we are still processing that, working with Treasury in making sure that they understand that we think our ability to get full value for Mileage Plan from multiple sources, partly from them and partly from public markets, is, in fact, in everybody's best interest. So we're working through that.

I think what we showed last time, we kind of gave you guys the road map that suggests that the Mileage Plan value was a little over $5 billion. And you can sort of apply your best guess on LTVs or how much we could get from it. But the government is capped at $1.1 billion, and we think we can raise much more on the $5 billion or more base of value that we have.

Operator

Your next question is from Savi Syth with Raymond James.

Savanthi Nipunika Syth - *Raymond James Ltd., Research Division - Research Analyst*

Appreciate all the color on the cash burn and everything. I was kind of curious, so does this $250 million structural program, I realize it's a stretch goal, but does that get you to cash breakeven today if things do not improve the way you're thinking about it?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Thanks, Savi. They're totally connected. And I want to make sure that everybody is clear. It's really a run rate. It's an exit rate that would annualize at $250 million. So it's not necessarily structural reduction of $250 million between now and the end of the year. It's definitely going to be part of the formula that gets us to cash breakeven.

I think even on the 40% to 60% revenue scenario, we would have to do this to get there. But beyond that, obviously, cash breakeven is a waypoint on our way back to some level of profitability and paying back our debt and growing again. And there's no doubt in our mind that we will have to be very aggressive on restructuring the company to ultimately get back into a growth trajectory and to pay down this debt that we've taken on.

Savanthi Nipunika Syth - *Raymond James Ltd., Research Division - Research Analyst*

That's helpful. And then if I might follow up on the revenue answer and commentary. So I'm just trying to understand as you think through kind of the projection here. The September average, is it kind of fair to assume that September doesn't do as well as August on a year-over-year revenue basis because it historically relies more on business passengers or are you kind of based on kind of the build you're seeing in leisure, et cetera, is that not a fair assumption?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. Savi, I'll -- and I don't know if Andrew wants to add color. I think it's a fair assumption that September would be worse than August based on what we're seeing today. I don't know that I would sort of say that those are the drivers. But as Andrew mentioned, we don't expect business travel to be back anytime soon, certainly not by September.

I think we would have hoped and expected that had the country not had to sort of go back into a shutdown mode, that we would be seeing incremental gains sequentially through the quarter. And that just doesn't look like it's going to happen right now, and that's kind of what Brad and Ben both touched on in the script.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Yes. Savi, it's Brad. I think there's normally maybe, there is business seasonality which would help most Septembers. But September is still, the weather is still good. Kids are going back to school. I really think what we're seeing is what all airlines are seeing is the news feed has just changed, that the coronaviruses have spiked. Quarantines are moving from July 1 to August 1 to September 1. They could go longer. Employers are announcing basically that they don't want their people traveling and that return-to-office schedules are being delayed. Schools in a lot of our geographies -- that's the driver. And we've seen it.

We tried to say this in the prepared remarks. Sometimes you see this up more clearly in retrospect, but we were on a really nice clip through the July 4 weekend in terms of, seems like every day, there was 1,000 customers more than the previous day.

But as the narrative changed and as the headlines changed, I do think every airline has seen softness in bookings for future travel. And that's the thing that's making us nervous about August and September. While we're on it, I do want to say that we're committed to managing our schedule responsibly and we're committed to doing everything we can to get the cash burn of 0 at or near the front of the pack of the industry. We're not giving these industry commentary as an out or anything like that. We're going to manage what we can control as good as anybody out there, I believe. But I just do think folks should know that the environment is -- and I think you know this already. The environment is quite a bit different than it was 30 days ago.

Operator

Your next question is from Hunter Keay with Wolfe Research.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Passenger Airlines, Aerospace & Defense*

So I think you're secure enough for me to ask you this question. Obviously, COVID is an opportunity to make a lot of changes that can't be made when times are good. So what are 2 or 3 things that you think Southwest Airlines does really well that you think you can mimic for yourselves?

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

Well, Hunter, it's Ben. I think right off the bat, I think our company respects Southwest tremendously. They're a great company and they're led by fantastic people. I think when you look at Southwest, I think their success lies on a core of having a low-cost structure. And that is something, as you know, we focused on our whole -- at least in my whole career here and Brad's whole career. So a low cost matters in good times or in bad times. So I think if there's one thing that we both admired about Southwest and will continue to emulate is that a strong balance sheet. Shane said it, the less cash we burn, the less we need to pay off when we get out of this. So we need to get through this crisis, get to cash breakeven, start paying on this debt and get back to our trajectory of growth and then just having enough dry powder to take advantage of opportunities. And that's why we're seeing Southwest just fantastic growth, and we have the same mindset. So there are a lot of great things about them that we've admired and will continue to do so. Brad, I don't know if you want to answer.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

It's good.

Hunter Kent Keay - *Wolfe Research, LLC - MD and Senior Analyst of Passenger Airlines, Aerospace & Defense*

Okay. And then maybe you said this, I'm sorry, Shane, if not. You said it will take 2 years to restore the schedule of 2019 capacity. Does that mean that it should take about 2 years to get to that CASMex of 2019 or better, too? Is that fair?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Hunter, yes. In the script, that's what Brad mentioned that we -- while we don't have a crystal ball, we're looking out and thinking it's going to be a 2-year process. I would say we would want to be left of that. And we're not in a position to give you specific dates at this time. But I think what I said in my script was, our intent is to get to pre-COVID CASMex even if we're a smaller company on a sustained basis. And so we're working through that. We'll have more to talk about on the next call, I'm sure, on this topic. But no, I don't think that we're waiting to get back to pre-COVID capacity to reach our pre-COVID CASMex.

Operator

Your next question is from Jamie Baker with JPMorgan.

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

Just first, just a quick follow-up. My line was cutting in and out. You were discussing a cap at Treasury. Maybe I misunderstood, but what specific cap were you referring to?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. Jamie, this is Shane. So they are limited in how much they can loan to each of the airlines, right? It's a $25 billion package and it's apportioned based off of capacity pre-COVID. And so they can only loan us up to $1.128 billion. And what we were saying is, we think our Mileage Plan assets could fetch more than that in total. We don't want to be limited on how much we can go do with other parties.

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

All right. Okay. We're good then because I thought maybe you were referring to some arbitrary cap that they had put on what they can accept in total in terms of -- from the industry on loyalty as collateral. So I apologize for that.

Getting back to a pre-COVID ex fuel CASM level on a smaller footprint, do you believe you can get there without changes in wages and work rules?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

It's a good question, Jamie. I'm not going to totally speculate on that at this point. I will tell you that it will require us to reach pre sort of peak levels of utilization and productivity, which we've got to do. We were, I think, one of the best in the industry in terms of the productivity of all of our Air Group assets, airport assets, airplanes. Because of growth, congestion, integration, dual fleet, we've stepped off of those peaks recently, and one way to get back to where we need to get back there is to reclaim those peaks.

So I totally appreciate the question. I get where you're coming from. I think it's a little premature to know exactly how we're going to go do this, but we're going to be willing to talk about this stuff as we move forward.

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

Got it. And if I can sneak in a final one. I assume you're in possibly daily contact with officials in Hawaii. Do you care to hazard a guess as to whether the modified September 1 date holds and how forward bookings are looking beyond that date?

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

Jamie, it's Andrew. We've obviously seen it extended a couple of times now. We're staying in close contact. I don't know where it's going to be, but I certainly think there's a high risk that, that may slip again. But again, we just monitor that, and we take each day as it comes.

Operator

Your next question is from Catherine O'Brien with Goldman Sachs.

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

So on the month of June, cash burn improvement we saw through the quarter from your initial guide back at 1Q earnings. I know you gave some color on what drove that better performance. But can you just help us think about proportionately how that better performance was driven between cost and better demand? And then as a team, it seems you have quite the history of finding incremental cost savings. So any ongoing projects that drive cash burn down from that $200 million figure you've gotten July out there, even excluding a better demand backdrop?

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Catie, I might start and get Shane, Shane is going to talk about the cost side. But I think a big driver is our network and our low-fare proposition. If you actually look at our revenue line, our revenues were down 82%, which I said in my script. That's a bad result for any business for any industry, but it might be the best in the industry or very close to the best in the industry. So I think the combination of our route network, where we fly, how we fly, our fare structures, our loyalty, that was something that served us well in the second quarter. It's something that's going to serve us really, really well in the future.

I do think, Shane, the cost side of it is a -- Ben, you're talking about that. That's a muscle that Alaska has historically had and relied upon, and that's something we're going to be at the gym making that muscle work even better for us. Maybe you can talk about that side of things.

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. Catie, it's a great question. I would go back to, it was really important that we got all of the variable cost out that we thought we should and we did. And I talked about this last quarter, a 1:1 relationship on the variable costs, which is good to prove. We always think we know what the variable costs are, but we were able to prove that out.

There were a lot of things that we did in the immediate term that were probably more temporary, and that's why we're starting to shift the conversation to structural cost reductions. A lot of the stuff in this quarter was just suspension of all discretionary spending, really aggressive offering of voluntary leaves, which, as I said in the script, 30% of our folks took, which was a huge help on the payroll line.

There wasn't a lot of structural stuff that we had done in the quarter, though. And that's what we've got to go start to work on. The first thing that we've done is reduce the management team size, which I mentioned in the script as well. And we're working on that list of ideas that we've got to go execute on to get the rest of this goal that we've got out in front of us.

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

Okay. Great. Maybe one, I don't know how this would factor into your thought process on driving those structural costs out. But any updates for us on the fleet decision to remain a 2-aircraft-type carrier, go back to single fleet? And then how should we be thinking about lease return expenses for the rest of this year and next? Obviously, not as big of a factor as it was pre-COVID, but still one to think about.

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

Catie, it's Nat Pieper. I think, no question, the fleet is a healthy proportion of the structural savings that Shane is talking about. And academically, you kind of can think of it this way, if you're going to keep a mixed fleet going forward, you better leverage that to get advantages in ownership cost, better lease pricing and using competition, and also on the revenue side, having different airplanes to match the different markets.

The counter to it is on a single fleet, you better get operating efficiencies. And so as part of the structural savings, we've got to figure that out. And as we start to narrow down the Airbus aircraft that we have, we parked all 10 of our A319s last quarter and 2 of our A320s. We've got 39 leased Airbus A320s left that have expirations over the next 3 to 5 years. And we're starting to creatively look at ways to phase some of those airplanes out. So a lot of leverage in that question and a big piece of achieving the structural savings goal we want to.

Operator

Your next question is from Helane Becker with Cowen.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So can you guys codeshare with JetBlue through the American codeshare or just on your own?

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

Helane, it's Andrew here. Number one, I think we don't have a relationship with, obviously, JetBlue. And number two, we're not in a position to go into the privity of contract details with our West Coast international alliance.

I will say that we are very excited and very committed in discussions. And you've seen the recent oneworld invitation. But both American and Alaska, I think, are really well positioned to grow our presence and strength off the West Coast, both on the corporate side, the leisure side. And we've spent a lot of months putting together a very compelling alliance on the West Coast, and we're very excited to start to get that into motion.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Yes. International isn't top of mind for people today understandably, but competitively being able to go into the marketplace when corporate travel is back and have a robust solution that covers a extraordinary domestic network, but also international is important. So we're going to push this thing hard so that when we have international travel again, which we will, we're really well positioned.

We're super excited. American has announced service from Seattle to Bangalore and Shanghai and London. And the oneworld offering out of Seattle and other West Coast cities is just going to be really, really strong. So we're excited about this, and we're going to push it hard.

Helane R. Becker - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Yes. I appreciate that. And then for my follow-up question is, as you think about coming out of whatever we're in now, this COVID, this dreadful situation and you think about winning the recovery as a smaller airline, do you think about -- I mean is it -- does this really give you a chance to pull out of markets that maybe didn't make sense before but that you were sort of flying because you'd either always flown them or because Virgin America had been in that market, and they had kind of always flown them? Like does this give you a chance to be more thoughtful about where and when you fly?

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Helane, I think the answer is yes. And Ben and Andrew may have something they want to say to this as well. But I think if you actually look at it, a lot of those changes have been made. It does give us a chance to sort of to rerack the route network. And as you've seen, we're taking cities through the -- the way I sort of think about it, Anchorage, we say anything that we can fly out of Anchorage, we do fly. You see us do that. Seattle, we've done a lot to fortify our position. Portland, I think there's opportunities for us to solidify and grow.

We've got strongholds in the northwest in cities like Spokane and Boise and Redmond, Oregon and Missoula and Bozeman. And there's opportunities to connect those northwest cities which have a ton of mileage by members to cities like San Jose, San Francisco, LAX and San Diego. So we're doing some of that.

Andrew, you've done some stuff very recently out of LAX, which -- I think the answer is yes. There is a chance to sort of reconfigure and build the network around what we do best. In terms of holding your breath for additional things, I don't know that I would. I think a lot of those moves have been made. But Andrew, maybe you disagree with that. I don't know what you'd say.

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

No. I think Brad's spot on. And I think if you look at our pull downs in our network in general and even in California, we are still in the majority in the utility of the California network, just at a significantly reduced frequency.

And as Brad mentioned, really some of the L.A. moves is really just a general reshaping of our network. But I will agree with one thing in respect of all of this is that there is a rebaselining of the nation's networks. And you are seeing all carriers having to make deliberate choices about where they're going to serve and where they're going to make adjustments. And I think that's going to play out over time, and we'll make sure that we are focusing on that as we move forward.

Operator

Your next question is from Duane Pfennigwerth with Evercore ISI.

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

Just a philosophical question maybe, given that a lot of the questions were asked, about leverage limits at the Board level. There are so many interesting questions right now about collateral and all the things you could potentially lever up, your Mileage Plan, your brand, office furniture, paper clips, all of the things you could potentially lever up. Why are there limits? Does it make sense to borrow against every last scrap of collateral that you have right now? And if not, why not, based on the history of the organization?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Thanks, Duane. I think that what's imperative for us is to weather whatever shape the downturn and sort of choppiness of recovery is. I think even with all of the raisings we've done, we're still sub-60% debt-to-cap. And if we continue to go out and get $1 billion to $2 billion of additional liquidity, we'd be under 70% or 75% debt-to-cap. So we still have the balance sheet room to where -- I think the question is totally valid but a little premature because I don't think we're running up against kind of the limit of using what sort of nontraditional assets like brand and sort of other things like that to go and further solidify our liquidity.

But I'll tell you, our view is, we are going to go raise the amount of cash we need to weather this, and we'll manage the cost side super aggressively. Once we get to cash breakeven, it's academic, we can sit there for as long as we need to. So we're talking about both, but they're both paramount in our mind. There's not, I think, a limit right now in front of us where we're saying, it's too much and we're going to stop. Once we get there, though, we obviously will come back and share that with you guys.

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

Certainly not a criticism of where you are now. But I guess, drawing on the long-term history of the company, what's the downside of being overly burdened with debt?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. I mean our -- the balance, obviously, and we've talked about this a lot internally very, very openly with our employees is, anything you borrow and you actually use to finance losses, you got to pay back. And you got to pay that back through cash flows in the future, and that steals from your ability to grow. And we don't want to steal from our ability to grow. So we have a mindset about how much total net debt we're hoping we come out of this with at the end of the day and that it's at a rate that allows us to aggressively pay it back while still growing the company out in 2022 and beyond.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Shane, so we want to borrow, we just don't want to use the money. Like one mental model we have is, have the finance team hard at work borrowing, I don't know if it's as much as we can but borrowing, really shoring up our liquidity. And then hopefully, things get better and we start paying that money off. That's kind of the mental model that I see for the finance team. It's do everything we have to do to ensure our sort of staying power. But then at some point, we'll have a vaccine, things will be better. And as soon as we get there, we start reducing those debt balances.

Operator

Your next question is from Mike Linenberg with Deutsche Bank.

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

Just 2 here. And Brad, your initial comment, and you followed up with about the testament, your cash burn being where it is, probably best among the industry, appropriately sized. You mentioned it being a testament to your route structure and low fares. And then Andrew, I know on Helane's question, you sort of touched on some of the changes you're making to the network. But when we sort of look at the changes that you have made and have announced, you've probably made more changes to your network really in the last 3 to 6 months than, I would say, the competition. And I'm just curious, how much of it was a function of responding to COVID-19 and maybe moving aircraft out of business markets and putting them more into leisure-oriented markets or how much of this was maybe a function of the American agreement back in February, where you want to reposition airplanes so that maybe you have better connectivity across both networks or maybe it's a little bit of both. I'm just curious about sort of the thinking and what's driving the change to the network.

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

Mike, I mean, just at the highest-level summary, I think the most significant changes, I think, you're referring to are really boiled down into serving secondary Pacific Northwest markets from California. I mean, if you look at the vast majority of the changes in numbers at the high level, that's what they would be. And I think these are markets where we are strong. We've got good regional aircraft right now to do this, PDEWs make sense for us. And that was sort of part of our strategy shift. And as we got into this, it still made sense to do those. I think some of the other changes you've seen are just retweaking and looking at, for instance, L.A. and making sure that we're positioned on the leisure side, which we're solid at.

So I think overall, but I think at the end of the day, if you look at the network, it's essentially utility-wise, the same, except that frequencies are significantly down right now in these massively depressed transcon market in California. And we've pretty much maintained everything in Seattle from a destination perspective.

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

Okay. Okay. That's helpful. And then maybe to Ben, on the airport side. We've heard airlines, as an industry, talk about ways to improve peace of mind with customers, finding ways to get them to want to travel again. And the concept of temperature screening by the TSA, it's been kicked around for some time now. It feels like several months. And yet, I'm not sure if it's gone anywhere. What are some of the gating issues in trying to move that along?

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

This is on temperature screening. Diana, you've done some work there. Yes.

Diana Birkett Rakow - *Alaska Air Group, Inc. - VP of External Relations*

So we are strongly advocating for the TSA to take up temperature screening. We're doing a proof of concept with the Port of Seattle here in the SeaTac airport. Honestly, I think there's some just varied science on whether or not it actually does sufficiently screen people, whether there's enough people that are caught with temperatures high enough to actually screen them out. And so there's ongoing debate about whether or not it's worth putting it in place across airports. But we are continuing to ask for it. It's another layer of safety in addition to all of our steps in Next-Level Care. And it could increase guest confidence.

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

Like we have them here in the building, honestly, everywhere we go in. I'll tell you, it's slick technology. I don't know if you have it. You just put your face and literally 2 seconds it takes your temperature. And we're just saying, look, it's just another level of confidence for customers that come in to say, look, your temperature is normal. It's just another step in making sure that people are getting on board airplanes that are safe. So we're going to continue advocating for it. Likely not go as fast as we would like, but we're going to continue pushing on it because I think it's just part of the confidence of society and people flying.

Operator

Your next question is from Brandon Oglenski with Barclays.

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

I guess, Brad, at a high level, should investors expect that you guys not only want to manage to like a cash breakeven level or backing up before full recovery or should we even expect that, like if this drags on longer, that you guys could move towards earnings? And is that, I guess, from the outside looking in, is that even a prudent decision because if you expect demand to come back, maybe you don't want to cut costs that far. Can you just help us out on that?

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Yes. You broke up a tiny bit there, Brandon. So can you just summarize the -- your cell phone or something broke up a little bit.

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

Yes. Sorry about that. I guess I was just asking whether it's prudent for you guys to be managing towards positive earnings in this environment or is that not the right mindset?

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

No. I think it's the right mindset. I think there is a balance that any business would look at in terms of staying power and liquidity and sort of doing everything you need to do from a cash flow, P&L, fundraising perspective to be in total control of your future while seizing strategic opportunity on the other hand.

And I do think if you guys have followed Alaska for 10, 20, 30 years through these different crises, you've seen us be very contrarian. You've seen us make some of our boldest bets when things are down. So I think it's a good question.

I think for now, though, demand is really, really down for all airlines. And so we believe the right move for Alaska at this juncture is to get our schedule right given the demand that we have and to continue to do the things that we're doing on the liquidity side.

On the cost structure side, I think we want to do the things that make us better and stronger coming out of this. I don't know -- what I'm trying to say is, if we do see opportunities, we want to have the balance sheet and the mentality and the will to take advantage of those opportunities. Right now, what we see is an imperative to sort of get resized given the extraordinarily weak demand that all airlines, including Alaska, are seeing.

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

Brandon, I'll add on that. I think when you look at our Q4 capacity down 35%, I think we're in a good place. I don't think that's overly aggressive, overly conservative. It allows us to flex up or down and allows us to manage costs and also take advantage of an uptick in demand. So I think we're threading the needle pretty well on that.

Operator

Your next question is from Darryl Genovesi with Vertical Research.

Darryl J. John Genovesi - *Vertical Research Partners, LLC - Principal*

Andrew or if Nat's on the line, I think at the time you closed the Virgin America deal, you had to scale back the American Airlines relationship. Would you just remind us what you're not allowed to do with American and whether you're waiting on any regulatory approvals to reramp that relationship or the relationship with the oneworld carriers more broadly?

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

Yes. Darryl, I think there was a couple of components, about 50-plus markets in all. But essentially, we weren't allowed to cooperate on all the Virgin America overlap markets, which were essentially California; and then secondly, at a high level on our hubs, so Seattle, Portland, San Francisco, et cetera, we were not allowed to put our code on American's flight out of our hubs and vice versa.

So the best way to think about it is that the historical Virgin America network was sort of off limits. And then secondarily, really getting connections beyond American's network and beyond our network was still fine. So we continue to operate within those parameters, obviously, and look at what options on what we may need to do going forward. But I will say, as it stands today, we still, given those, have a lot of opportunity to work with American.

Kyle B. Levine - *Alaska Air Group, Inc. - Chief Ethics & Compliance Officer, Senior VP of Legal, General Counsel and Corporate Secretary*

And Darryl, this is Kyle. On your second question, we're totally clear of regulatory requirements. We cleared those hurdles, I think, in early May or so.

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

Yes.

Darryl J. John Genovesi - *Vertical Research Partners, LLC - Principal*

Okay. And then Shane offered up this $250 million target on the structural cost takeout. I mean is there -- even if you're not ready to disclose the number yet, I mean, is there something similarly substantial on the top line as it relates to the oneworld membership?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Oh, yes. So Darryl, yes, we haven't really put any sort of information out in terms of what the value of that might be. I don't think we're going to do that this morning either. But suffice it to say, Brad, I think, and Andrew both did a really good summary. The opening up of the globe through our major West Coast hubs and focus cities is going to create a lot of value for customers that we think we're excited about.

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

And the other thing I would just add is, it puts us on an international platform as it relates to our loyalty members. And something that we've always been missing in the Pacific Northwest is a good seamless global connectivity story with elite reciprocity across the globe, and this is going to bring us that.

Operator

Your final question comes from Myles Walton with UBS.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

Just a couple of cleanup questions, if I could. The first on cost reduction in the third quarter, 47% in the second quarter. What's the bogey that you're putting there for the third quarter?

Shane R. Tackett - *Alaska Air Group, Inc. - CFO & EVP of finance*

Yes. I don't think -- we didn't guide to that, Myles, and so we won't give you a specific number. I think incremental capacity will add some costs. And as mentioned, there are a lot of things that we just sort of took down. 70%, 80%, 90% maintenance spend was an example of that. You can't do that forever. We've got to start bringing aircraft out of storage, and we will have to start maintaining those.

So there are some things that we'll layer back on, on the cost side, and that's why it's important that ultimately we see a better sort of backdrop on the national sort of public health front so we can get some of this demand back going again and sort of regain the trends we saw in late June, early July. But I would expect the cost removal to be a little less in next quarter versus this, but we haven't guided to anything specific.

Myles Alexander Walton - *UBS Investment Bank, Research Division - MD & Senior Analyst*

Okay. And then one other cleanup. On the yield in the second quarter, obviously, up 30% year-on-year. Can you just give any nuance to what was going on there? And I guess the outlook for the rest of the year looks more normalizing to prior trends?

Christopher Michael Berry - *Alaska Air Group, Inc. - VP of Finance & Controller*

Myles, this is Chris Berry. The yields for the second quarter were a bit odd simply because we still have some residual stuff from the Mileage Plan program on flown miles that really related to the Virgin America acquisition years ago. So that sort of stayed about level, and that's why you see the yields pop in Q2. If you look at the real like raw passenger yields, they really were not up nearly that much. Raw passenger yields were up probably about 9% for the quarter. So you'll see that fall off as we move into third and fourth quarter, and it will be more, relative to year-over-year, it will look a little bit more real, realistic.

Bradley D. Tilden - *Alaska Air Group, Inc. - Chairman, CEO & President*

Okay. I think that's our final question. Thanks, everybody, for tuning in. We look forward to chatting with you next quarter.

Operator

Thank you for participating in today's conference call. This call will be available for future playback at alaskaair.com. You may now disconnect.