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EDITED TRANSCRIPT

ALK.N - Q2 2021 Alaska Air Group Inc Earnings Call

EVENT DATE/TIME: JULY 22, 2021 / 3:30PM GMT

OVERVIEW:

Co. reported 2Q21 revenues of $1.5b. Expects 3Q21 revenues to be down.

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PRESENTATION

Operator

Good morning. My name is Thea, and I will be the conference operator today. At this time, I would like to welcome everyone to the Alaska Air Group 2021 Second Quarter Earnings Release Conference Call. Today's call is being recorded and will be accessible for future playback at alaskaair.com. (Operator Instructions)

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

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

Thank you, Thea, and good morning. Thank you for joining us for our Second Quarter 2021 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.

Our financial results published this morning reflect a clear step forward in the recovery of our business. In the second quarter, Air Group reported an adjusted pretax loss of 3%. For the first time since February 2020, monthly adjusted pretax margins turned positive in June at approximately

14%. These results exclude any CARES Act payroll support program benefits. The pace of recovery during the quarter drove approximately $840 million in cash flow from operations, inclusive of the $489 million of CARES Act payroll support program grants received.

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 in 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 have 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, Emily, and good morning, everyone. The results we published this quarter showed that we are successfully rebuilding our company and returning to profitability. As Emily shared, our second quarter pretax loss was 3%, landing us close to breakeven as we had initially forecast during our Q1 call. Margins improved significantly during the quarter, as we exited March with a 41% loss and closed June with a pretax income of 14%. Our Q2 adjusted pretax margin is the best in the industry among carriers who have reported so far.

This quarter, we hit several milestones that validate our strategy is working. The first milestone was our return to profitability, exiting the quarter with solid double-digit margins. The second is that our business returned to positive cash flow generation of $351 million, excluding any PSP grant funding. Third, we used our strong liquidity position to begin to delever, bringing debt to cap down 6 points from the prior quarter to 56%. And lastly, with the strong return of passenger demand, our productivity levels rebounded to near 2019 levels.

Underlying these achievements is a dramatic return in leisure demand that began to gain momentum in March. To a lesser extent, business travel demand has been increasing more recently as well. Air Group's passenger enplanements progressed from down 34% in April to down 18% in July. We are consistently flying about 110,000 passengers per day, and forward bookings are approximately 85% of 2019 normalized levels. This progress and our second quarter results give us confidence that the worst of the downturn is behind us, but the impact of the Delta variant may pose some risk in the recovery trajectory. To date, we are seeing no signs of demand slowing, but we will continue to watch booking trends carefully so that we can appropriately match capacity with demand.

With that in mind, our plan is to return to 100% of 2019 flying levels by no later than the summer of 2022. However, given that the recent surge in demand has been consistently strong and has not shown signs of slowing, we may accelerate our return to pre-COVID levels accordingly. To create flexibility for that faster ramp-up in capacity, we are planning to reactivate approximately 10 Airbus aircraft and begin flying them this fall and winter. This temporary return of several Airbus airplanes allows us to create capacity quickly and protects against unforeseen events that could be outside of our control, such as supply chain disruptions.

Last quarter, we spoke about deleveraging, our cost structure, fleet plans and commercial tailwinds to move back to a path of sustained profitability quickly. It's clear from this quarter's financial results that our approach to managing the business is working. For Q2, we expect our pretax margin, load factor and unit revenues to be near the top of the industry as a result of our disciplined approach to capacity.

With growing passenger counts, our productivity has increased 1.5x between March and June and is expected to be within a few points of 2019 levels in July and beyond. This sets us up well to further close the gap on 2019 CASMex levels. As we look forward to the next 6 months, we expect to deliver double-digit margins throughout the third quarter and high single-digit margins in the fourth quarter. It's also worth noting that the gap between our 2021 and 2019 margins is closing each quarter. I'm proud of how quickly we've returned to profitability and how, as Shane will detail, we have begun reinforcing the fortress balance sheet that has been a hallmark of our business for many years. Our financial strength sets us up well for sustainable growth in the future.

Impressively, our operation performed near the top of the industry in on-time arrivals and completion rates even with the rapid return in traffic during the quarter. At our Seattle hub, where our flying is essentially back to 2019 levels already, we have found that entry-level labor pools are limited, making hiring a challenge, particularly for ramp workers. This staffing pressure, along with record-breaking heat waves during the quarter, have put stress on our operations. Yet through these challenges, we've delivered for our guests with caring service, creative solutions and teamwork.

I want to recognize the incredible efforts of our employees across the operation, including airports, ground handling, contact centers, in-flight, flight operations and maintenance teams, many of whom have covered extra shifts to keep our operation and guests moving as peak summer travel got underway. Even our back-office management employees at all levels have jumped in to help the operation the past couple of months. One of the things I truly love about this company is our culture, and how our employees support each other and take care of our guests no matter what it takes.

While it is inevitable that we will encounter new challenges and uncertainty as the recovery advances, our momentum continues to build. Our measured deployment of capacity allows us to maximize financial results while allowing our operations to scale up successfully. It's exciting to see Air Group's progress as we rebuild our network and operation, harvest savings from cost and productivity initiatives and reinforce our strong balance sheet.

I am confident that this is exactly the strong foundation we need to further grow our partnerships with oneworld and American, leverage our 737 fleet order and launch our upcoming commercial initiatives.

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 it's great to be with you all again. My comments this morning are going to center around 3 areas. First, we're going to be talking about our second quarter revenue performance. But I'll focus on sequential monthly improvements in revenue versus quarter-over-quarter so that the trajectory of our revenue recovery is clear. Second, I will provide capacity and revenue guidance for the third quarter. And then lastly, I'll be touching on revenue initiatives that are getting ready to take effect or will be rolled out in the future to further enhance our revenue performance.

Starting with revenue this quarter, our second quarter revenues were $1.5 billion, down 33% from 2019, but nearly double the revenue we generated in the first quarter. As Ben shared, this reflects material increases in passenger volumes as well as sequential improvement in yields. This quarter, we flew 21% below 2019 capacity levels with load factors climbing from 70% in April, 75% in May and 86% in June. This acceleration put us just above our load factor guidance range for the quarter, and we expect load factors in the mid-80s for the rest of the summer. I'll speak more to our guidance in a few minutes.

Our RASM was down 15.5% for the quarter, but the improvement from the beginning of the quarter versus the end was dramatic. Our RASM was down 25% in April, 18% in May and only 5.5% in June. Much of this improvement was driven by passenger volumes, but yield also played an important role, which improved 8.5 points during the quarter from down 14% in April to down 5.5% in June. Mileage Plan revenues, including commission revenues from our co-brand credit card program and award redemption revenue showed particular strength during the quarter.

Collectively, Mileage Plan revenues represent nearly 20% of total revenues and were down just 9% versus the second quarter of 2019, with June down just 0.9%. Bank commission revenues were particularly strong for the quarter, up 7% versus 2019. Additionally, we saw credit card acquisitions for the quarter exceed those of 2019. We're encouraged by loyalty program performance, and it's clear that our guests are excited to engage with our program as they return to travel.

So turning to our network. Our strong sequential revenue performance was enabled by our network team's rebuild strategy. Air Group has returned to approximately 80% of its pre-COVID network size. But we prioritized Seattle growth, given the strength of demand here. Our Seattle hub capacity in Q2 was approximately 2% higher than in the second quarter of 2019. And the team also restructured the Seattle hub to gain access to greater flow traffic, which has helped fuel this growth. As of July, our Pacific Northwest flying is only down 4% from 2019. We expect to continue to grow Pacific Northwest capacity from here.

And Hawaii capacity has also been returned more quickly than system average and was only down 7% in the second quarter from 2019. We've reallocated some Hawaii flying across different markets, which includes adjustments to frequencies in both California and the Pacific Northwest, which has proven to be a positive move. Our California capacity was down 40% in the second quarter, reflecting the reality that demand in the state has been amongst the weakest in the nation. As we shared last quarter, we will add back capacity to California as demand returns, which we believe has now started.

During the first half of the year, there was an 8-point load factor gap that existed between our California and non-California flying. And with the state reopening mid-June, I can report that the gap has fully closed in the past several weeks. With California load factors improving, we're experiencing relative stronger pricing and yields on flights that touch California are now better than the rest of the system on a year-over-2 basis. As with our entire network, our priority is to continue to match supply with demand, and we fully expect to have returned 100% of pre-COVID capacity to California, sometime in the first half of 2022.

Even though system capacity remains below 2019 levels, we have been adding new markets to our network to maximize revenues as the recovery takes hold. We've seen a shift in demand during the pandemic to getaway destinations and cities with lower costs of living and our recent focus on growth in places like Boise, Austin and Florida are due to this reality. Since the beginning of the pandemic, we will have either commenced or announced over 50 net new markets, which reflects the shifting demand landscape in our network.

Booking momentum remains strong, stabilizing at about 85% of pre-COVID levels. This level of demand is consistent with our capacity plans, which are also approximately 85% of pre-COVID levels and supports our objective of returning to 80%-plus load factors and pre-pandemic yields. On the business travel front, we've been encouraged at what appears to be an acceleration of the return of business travel. In fact, over the past 3 weeks, our indirect corporate bookings have reflected 40% to 50% recovery of 2019 levels, and we're optimistic this will continue to improve. Similarly, direct corporate bookings that utilize EasyBiz were over 50% recovered in the second quarter. EasyBiz users generally skew geographically towards the Pacific Northwest and State of Alaska customers, but provide a good indicator of recovery trends for small and medium businesses.

We mentioned on our prior call that we expected business to recover to about 50% by the end of the year. But with recent trends, we expect it will reach sustained 50% or better ahead of that. As I also mentioned last quarter, oneworld and our partnership with American have opened the door to greater access to corporate travel. Just to give you a sense of our progress against that opportunity, to date, over 90% of Alaska's top-tier corporate accounts have either executed or are expected to execute a joint contract with Alaska and American, which will offer their travelers greater access to flight options, more competitive fares and seamless elite guest benefits.

Additionally, we will soon be working with several TMCs in a much deeper way. We have spent a fair amount of time over the last few quarter getting ready to fully leverage this distribution channel, which will ensure we are well positioned to get at least our fair share of corporate traffic as business travel recovers. In short, we will be competing on a more level playing field, and I'll have more to share on that soon.

With this backdrop, I'll turn to our third quarter guidance. For capacity, we plan to fly 17% to 20% below 2019 levels. Given the strength we see in summer demand, passengers are expected to be down just 15% to 18%, and load factors will improve to 82% to 85%. Revenue is expected to be in line with capacity at down 17% to 20% versus 2019, which means our unit revenues will be close to flat.

Looking beyond this year, I've shared that our larger share of corporate travel, new revenue management system, along with unique benefits available to us as part of oneworld will be critical to our return to sustained and profitable growth. Our team is in the process of sizing these and new commercial opportunities with a directive to deliver at least $300 million of incremental annual revenue to our pre-COVID revenue baseline. We plan to provide a deeper look into these initiatives and our expected delivery time line at a future investor event. As the next stages of this recovery play out, I look forward to bringing clarity to our investors who are eager to hear about our growth plans.

June was a turning point for us and delivering an adjusted pretax margin of over 14% gives me great confidence that our airline's revenue and cost model is configured to return us to industry-leading margins as we climb out of this pandemic.

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

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

Thank you, Andrew, and good morning, everyone. As our results this quarter indicate, the initial recovery of our business has been rapid and strong. After a deep loss in Q1, we saw margins improve substantially throughout the quarter, posting the double-digit margin in June that Ben mentioned. Nonfuel costs increased just 9% versus Q1, while capacity increased 29%, and our revenues increased 191%. Our results are solidly amongst the best in the industry, which is worth noting, particularly given that California was relatively later to reopen than the rest of the country.

Our results underscore the strength of Alaska's business model and our ability to execute as a company. My comments will focus on our financial performance, cash flows and liquidity, cost performance and our plans for the rest of the year.

Beginning with cash flows and liquidity. We generated $840 million of cash flow from operations this quarter, which is inclusive of $489 million in payroll support grants. Excluding PSP grants, we generated $351 million of cash flow from operations at the business. Most of the cash flow improvement was driven by ATL growth, which ended the quarter at $1.5 billion. $385 million of our ATL represents travel credits which guests continue to utilize for purchasing tickets. In the quarter, $185 million of travel was booked using credits versus our normal $40 million a quarter pre-pandemic.

Our on-hand liquidity at June 30 was $4 billion, up from $3.5 billion in March. We shared last quarter that we had plans to begin retiring debt in the second half of the year but accelerated that plan given the pace of recovery of cash inflows.

Debt retirements in the quarter totaled approximately $570 million, including the repayment of our $135 million balance under our CARES Act loan. We have now closed that facility and the underlying collateral that originally secured the facility is once again unencumbered, the largest of which is our Mileage Plan program. We expect to end 2021 with around $3.5 billion in on-hand liquidity, but will continue to reduce this balance throughout 2022. We have not yet determined a new normal level of on-hand cash in the future, but I do expect it will be somewhat higher than what we held pre-pandemic.

The debt repayments this quarter, as Ben shared, improved our debt to cap by 6 points from 62% to 56%. It's worth noting that our adjusted net debt levels dropped to approximately $725 million this quarter, given the excess cash we have on the books today. If we reduced cash by $1.5 billion to retire debt, our debt to cap would be at 47%, which is equivalent to when we entered the pandemic. I share this only to give a sense of how strong our balance sheet is as we move into the recovery. We do plan to use cash to pay down more debt this quarter, including our $425 million 364-day term loan.

Going forward, we will move from focusing on adjusted net debt, which was an important metric for us during the depths of the pandemic, back to focusing on debt to cap and net debt to EBITDAR.

Turning to costs. our cost execution was solid this quarter as productivity levels ramped. Total adjusted nonfuel operating expenses were $1.2 billion for the quarter, up 9% from Q1, while capacity increased 29% sequentially as I mentioned a moment ago. We saw productivity levels rise from 42% below 2019 levels in March to 15% below 2019 levels in June, and we expect July to be within a few points of 2019 levels.

Our Q2 unit costs were up 10.4% versus 2019, which was better than our mid-June guidance and was helped by $15 million in onetime favorable adjustments to wage and benefit-related expenses. During the quarter, we also accrued $34 million in expenses related to our performance-based pay incentive plan. As many of you know, our approach to incentive pay is unique in the industry, and we continue to see the value it has in driving clarity and alignment throughout our business on the goals we need to achieve to produce strong results as a company over the long term.

Also during the quarter, we were able to finalize 3 labor agreements, including a new wage agreement with our Horizon pilots and 1-year contract extensions with Alaska's flight attendants and dispatchers. I'd like to thank our employees and their IBT, AFA and TWU representatives for their diligent work to develop and ratify these agreements.

Looking ahead to the end of the year, I expect that our CASMex will continue to progress towards 2019 levels even though we're not fully back to 2019 capacity by year-end, with mainline approaching 2019 levels as we exit the year. To recap our expectations for the third quarter, we plan on flying 17% to 20% below 2019 capacity. Revenue should be down in line with capacity, resulting in unit revenues that are approximately flat to 2019. We expect unit cost to be up 10% to 12%, similar to our Q2 performance, given the relatively modest capacity increase quarter-over-quarter.

Given these ranges, we expect to achieve double-digit margins for the third quarter. Cash flow from operations is expected to be between 0 and $100 million for the quarter. The sequential decline in cash flow from operations is primarily driven by no PSP grant inflows and normal seasonality that we expect to see in ATL, which tends to decline in the third quarter.

Before we move on to questions, we want to express our appreciation for all the employees who have tirelessly contributed to our success in recovery. As you've heard today, folks in our operations have been working incredibly hard. The improved financial results that we are excited to be sharing with you today would not be a reality without the hard work of the 22,000 employees who bring our airlines to life each day. And with that, let's go to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Catherine O'Brien with Goldman Sachs.

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

So your June Q cash flow came in quite a bit better than initial expectations, in part driven by better forward bookings. But your capacity cut for the third quarter is only, I think, 2.5 points narrower in the second quarter. Is that the max capacity you could produce given the fleet changes you've made over the last year? Or is the demand uptick we're going to see that more in higher loads and yields?

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

Katie. Yes, our capacity is sort of where it's going to be for the third quarter. And so the loads and the yields is what's going to drive the revenue performance.

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

And so when you say the capacity is where it's going to be, does that mean that's kind of the max in terms of headcount and fleet availability?

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

Yes, that's correct. Our capacity guide because what we've tried to do when we set this up, costs are always certain. Revenues is not so much. So we've set this up so that we've got a very solid handle on our costs with a good level of capacity because there is room for growth on the yield front and the load factors. And so that's where we're going to be for the third quarter, in that range that I shared.

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

Yes, Katy, I might just add, I think we've talked about this before. We do want to get back to 80%-plus load factors on a sustained basis. We're not looking to see a lot of variation as we move from peak to shoulder. And so this pent-up demand that we're seeing in the summer, it was -- we didn't know how much of that would follow into the fall. So I think we've been pretty methodical about capacity and that's how we've set up headcount for the third quarter. But we are going to reactivate these 10 Airbus, and if they come online and it looks like there's opportunity to use them, the demand is there, we will deploy them. But it will probably be more fourth quarter for that.

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

Okay. Very clear. And then just for my follow-up. Like most of the industry has reported so far, you're expecting capacity cuts to narrow a little bit in the third quarter versus 2Q, but CASMex inflation to pick up a little bit sequentially. Is that all just ramp-up costs tied to bringing on more capacity? Or what's driving that? And how should we think about maybe some of those ramp-up costs flowing or not flowing into the fourth quarter?

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

Yes. No, thanks, Catie. I'll speak to that a little bit. I think there's a little bit of Q3 cost that is ramp up, getting ready for Q4 and next year. But a couple of notes. We outperformed our Q2 guide handily. We did have this benefit of $15 million in onetime items. There are also other areas like medical came in way under our original forecast. It's a little bit hard to forecast right now when people are going to go to the doctor, so volumes were down. So some of that isn't in our Q3 guide. We don't expect onetime items. We're sort of expecting medical to normalize.

But the biggest driver for us sequentially is selling expenses are now coming back in a big way. ASMs are only up a few points quarter-over-quarter. But passengers and revenue are up 25%, 30% quarter-over-quarter. So we're starting to see commissions and credit card expenses rise. Also in the third quarter, we'll have our full catering complement on board. So more people getting more food and beverage similar to where we were pre-COVID. So we've got -- those are all variable costs. They're not structural. I'm not worried about them at all, but they're coming back with demand, and they're all coming back in the third quarter pretty strong.

Operator

The next question will come from Helane Becker with Cowen.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So my first question is related to something you said, Shane. I think you said that you were seeing bookings at -- about $185 million worth of bookings are using credits versus $40 million pre-pandemic. So as you think about going into the third and fourth quarter end, and that would -- and working out those travel credits, are you going to get back to that $40 million level? Or is there a new level that we should think about?

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

Helane, this is Chris. We won't get to that $40 million level this year because, obviously, the remaining travel credits are much more elevated over where they were pre-pandemic. We've got about 25% of our total ATL, as Shane mentioned, in travel credits that still remain. Most of those do expire at the end of this year. So we expect those to be used at a pretty heavy pace for the remainder of this year. And then as we get into 2022, we would expect those to start to normalize then.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Okay. And then it normalizes back to around $40 million?

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

Well, I mean, that's hard to tell. I mean that's just what it was. And yes, we do have the element of no change fees anymore. And so it may be higher than it has historically been, but it will definitely level off from where it is now.

Helane Renee Becker-Roukas - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Okay. And then just for my follow-up question. I think, Ben, you mentioned that you're having a hard time hiring ramp workers and, I guess, other nonunion -- or maybe they are part of the union, but other workers. So how should we think about like attracting people to the profession, to the airline industry in general, if they are unionized and you can't raise starting pay? Or can you raise starting pay so that you can attract people? And does that lead to wage inflation for you?

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

Helane, it's a great question. I think this is a national issue as you're hearing a lot of companies talk about this labor shortage. I would say the only place we're seeing it now, we're not seeing it with pilots or flight attendants or a lot of labor groups. Where we're seeing it is really at the entry-level position, particularly in Seattle, there are spots across the country, but particularly in Seattle.

So what we're doing is really looking at the market. I think we want to be prudent about this. We're looking at the market. We're looking at what it might be in September and October when the stimulus and the unemployment runs out. This thing needs to find its water level, so we're going to approach slowly. What we've done now and our operations team has done just a phenomenal job with some incentives to attract workers. And so we're doing fine now. But it's just something that's on our windshield, and I don't think we know where that number is going to be for just a few more months.

Operator

The next question will come from Duane Pfennigwerth with Evercore ISI.

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

Congrats on this outlook. Only because you gave it, and I apologize for asking this because you gave good disclosure. But just on June 14%, can you put that in context? Like what is a June typically look like relative to kind of the rest of the second quarter?

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

Yes. So Duane, I'll give you some context. I mean if you look back at 2019, the June 14% this time is about 10 points lower than say it was in 2019. So June, July, August tend to be our highest margin months, and they're typically in the 20s.

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

Got it. I guess I was asking relative to the other months of the quarter because it just -- it sounds like you're saying you saw a much better kind of trajectory, much better kind of sequential build in margin than you normally do.

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

Yes, Duane, it's Andrew. I think the best way to describe that is the capacity was fairly even in April, May and June. But what you saw was load factors going from 70% to 86% and yield declines from down 25% to 5.5%. So the revenue and volumes really made the difference there over the quarter.

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

That's great. And then just with respect to 3Q, and this might just relate to what you just said. Maybe you can speak a little bit to kind of the visibility coming in and kind of the advanced book yields. Because it felt like the industry needed to overcome kind of the advanced book yields coming into 2Q, but they're in a much better place coming into 3Q. And maybe you could just comment on like your stage changes because this is, listen, this is not a massively long-haul network that's contorting to be short haul, like flat RASM in 3Q feels a great outcome.

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

Yes. Thanks, Duane. Off the top of my head, I don't know our stage, but that's not really the story. I think to your point, what we're seeing is, and honestly, as I look out, that's why we shared flat RASM. From what we've seen today, our yield position looks good and much better than it was in the second quarter, and the bookings are coming in well. I think on the business fare side, the environment is still weak. Just to be frank, the leisure is much better, but I suspect as business travel demand returns, I think we might see a strengthening there. But as I look forward right now, I feel pretty good about how we're positioned from both a load factor and a yield perspective and incremental improvement from the second quarter.

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

And Duane, I'll add, I think we're just being disciplined on how we deploy capacity. I think that's the big story for us. We've been very thoughtful from a year ago and how we're going to deploy capacity, bring people back, scale up the operation. And I think we're going to do that through the third quarter and the fourth quarter and into next year as we ramp up to 100%. We're going to watch what's going on, watch demand and react appropriately.

Operator

The next question will come from Savi Syth with Raymond James.

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

Just to follow up on Catie's question, as you bring those kind of 10 Airbus back this year and given your fleet order, just -- where do you think -- not looking for guidance, but what's the kind of the high level and the low level of where capacity can go in 2022?

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

Savi, it's Andrew. Yes, so if you look out, these Airbus aircraft start to return by the end of the year. But if we flew them all at normal utilization, so summer of '22, we could increase summer of '22's capacity up to 8% versus where we are in '19. So as it stands today, we've talked about getting to flat. But if we really needed to or wanted to, we could get up 8%.

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

That's helpful. And then Andrew, I know you teased this a little bit on the $300 million incremental. I was just kind of wondering if that's related to items that you have put in place today? Or if there is things that you have to actually turn on to start achieving that at some point? I realize it's not $300 million next year, but just from an execution standpoint, what's involved related to that?

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

Yes. Savi, I'll start with that and then hand over to Andrew. So when we put our 2025 strategic plan in place prior to pandemic, we've built it up with a lot of strong commercial initiatives that had that $300 million. And then the pandemic hit, we kind of put everything on ice to address cash burn and get back on the path of profitability. So at our recent offsite, all these initiatives are being refreshed. And I can tell you, Andrew is stoked on getting going. So maybe, Andrew, maybe just -- I just wanted to give you some background that these things are just not new. These are things that have been in the hopper for at least 18 to 24 months. But Andrew, maybe just a little color on that.

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

Thanks, Ben. Yes, Savi, I mean there's sort of 7 categories. And yes, some of them were there pre-pandemic that was ready, but there's also been big changes in our business like corporate contracts, TMCs, American, oneworld, merchandising, and we've got some network restructuring and changes. So I think as we roll this out, but I feel very confident that it's almost like we're on the runway barreling down at full speed and then the pandemic hit. And we were so close to starting to roll some of these out. And now that demand is returning and our businesses is reestablishing, we're going to get to rolling these out.

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

So Savi, I'm going to jump in too, so you get all 3 of us on this. I just want to reiterate, the plan is sort of a 4- or 5-year plan. So we'll talk more about specific timing at an investor event, which we'll hold at some point in the next quarter or 2. But the whole -- the cost restructure plan and the commercial plan is really predicated on 2025 ultimately getting there. So I just don't want people to get too excited about next quarter on this stuff. But we are excited about the initiatives that we're going to be undertaking.

Operator

The next question is from Hunter Keay with Wolfe Research.

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

Andrew, have you ever contemplated -- you and your team ever contemplated like a fully transparent or predictable revenue management strategy, basically nondynamic pricing?

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

Hunter, I think no, is my short answer to that. But if you want to expand on your question, happy to give you more color.

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

That's fine. If the answer is no, then it's no. We'll talk about it some other time. But...

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

I think I would say like I think we do try to be simpler than a lot of other folks. I mean it is -- you know -- I mean, you know this well. It's a complicated sort of discipline. But we were I think the first domestic airline to go to one-way fares. We have had a pretty small number of buckets relative to others. We've had sort of caps at the high end historically. And we have tried to be fair and simple with a lot of this stuff. But sort of a one-price-fits-all or something like that, I don't -- I think it's probably revenue negative, so we haven't really looked at that.

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

And it's all good to hear. I mean, you all stimulate our thinking, so maybe following this, we can hear more.

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

Yes, let's talk about it some other time. It will be -- I have some ideas. But anyway, one other question for you, Shane. You talked about pulling the Airbuses out. You mentioned supply chain disruptions. Are you suggesting there's some risk to the MAX delivery schedule?

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

Hunter, no, I mentioned that. We just meant those -- I will tell -- I am 100% confident in Boeing's ability to deliver. Our view is that there are things right now in the economy with supply chains that some of us can't even see. Out of our control, out of Alaska's control, out of Boeing's control. And these Airbus, what it does, it just gives us dry powder to either backfill any issues that we may experience because of it. Or like Andrew said, we can grow up to 8% for the next summer of 2022. So again, with a prudent approach to capacity discipline. So it's just more arrows in our quiver for us to manage going forward.

Operator

The next question is from Joseph DeNardi with Stifel.

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

Shane, just following up on an earlier question, if capacity in summer 2022 is up 8%. What does CASMex look like in that environment?

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

Well, I'm just going to be careful. If we're up about 8% is the question, I don't know that it will be. But I think our view is by the middle of next year with sort of the full ramp of our cost restructuring initiatives, we're going to be in a really good place. We do expect to be at or below pre-COVID CASMex, ultimately. We've said that from the very beginning. I don't know if we would hit it by next summer, but we should be there or getting very close to there. But I don't think I'll be more specific than that. It's -- I think we're going to have a really good cost structure.

One thing we know we're going to not do is lose sort of relative advantage to others in the industry. So we're super focused on this cost discipline and execution. The productivity stuff that we're seeing right now makes us very -- makes us feel very good about how we've executed to date.

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

Okay. That's helpful. And then, Andrew, can you just talk about kind of customer behavior you're seeing? Like are folks flying more? Are they spending more than they did in 2019? Or is it just kind of compressing normal behavior into a tighter window? I'm just curious kind of what changes in behavior maybe beyond that you're seeing and the degree to which that speaks to kind of the sustainability of this leisure demand strength?

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

Yes. Thanks, Joe. I was just talking to my team yesterday about this. Looking out into the fourth quarter, I think what we're actually seeing, at least from our network's perspective, is actually people are booking earlier and further out than they were in 2019. So as we sit here today, we're seeing good intake volumes for the fourth quarter. And if you just take a look at our credit card spend and our loyalty portfolio, in fact, we have had -- we had the highest spend in this company's history this quarter on our credit card portfolio. So we're just seeing sustained strength. And honestly, as I look further out, it's still maintaining. So that's what I see today.

Operator

The next question is from Jamie Baker with JPMorgan.

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

So Ben, not so long ago, you and I were talking about when you might reintroduce pretax -- longer-term pretax margin targets and whether it would simply be the pre-COVID 13% to 15% or possibly something even better. In your prepared remarks today, I kind of thought that's where you were going, but you stopped short. What else do you need to see? Is it the macro environment? Is it Alaska-specific? Maybe it's related to future labor economics. I don't know, before you're comfortable replanting your margin flag, so to speak?

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

Jamie, it's a great question. I think what we need to see is just a little more stability in the economy. Like for example, you got this Delta variant there that might create some choppiness in the recovery. So I think we just want to be cautious. I mean, just from my perspective, I feel pretty confident that the worst is behind us. I think we've started with a strong pretax profit in June. And I think we should easily sustain it going forward. But I think we want a little more certainty, closer to the windshield, see what's going on out there with labor markets, with the return -- the strength of the economy, there's inflation, there's all these things. We just want to see this stuff settle down a little bit. And I think come Investor Day, I think we'll give you more information on that and give you more visibility. But it's like you said, we're slowly getting there. And I think today is as far as we want to go.

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

And as a follow-up, I think it was Joe's ex-fuel CASM question. Can you just review for us what the headwinds and tailwinds are? Because on my list, I have more entries in the tailwind category. But of course, not every entry is equally weighted. I'm just having a hard time coming up with anything that would prevent you from having modest to materially better ex-fuel CASM by next summer. So just looking for a little more color headwinds to tailwinds.

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

No. Thanks, Jamie. I do think it's capacity at the end of the day. The fixed costs are kind of stable. We like where they're at. A lot of the cuts that we did during the pandemic has held and we'll be very disciplined on that. The variable costs are coming back as we would expect ratably. And so to us, capacity is the biggest thing, just getting the ASMs back out there to cover fixed costs over. There's not a major headwind. We will see about -- there's going to be another sort of round of labor deals at some point. I don't know when those will happen, but a lot of groups were open across the industry, pre-pandemic, and it's hard to say when all that stuff will get going again. But my guess is that, that's going to be relatively equalized throughout the industry. So to us, it's just -- once we get back to our pre-pandemic level, we're going to be in a really good position, I think, from unit cost.

Operator

The next question will come from Dan McKenzie with Seaport Global.

Daniel J. McKenzie - *Seaport Research Partners - Research Analyst*

So I wanted to follow up on that question as well. Returning to industry-leading margins in the next cycle. That's what caught my ear in the prepared remarks. It sounds like from the last question that you can get back to your historical margins. Big picture, what are the biggest drivers for getting there? What are the biggest pieces to the Alaska story for achieving that? And I'm just wondering, maybe you could rank the revenue and commercial initiatives versus the cost initiatives? I mean there's a lot of new things in play for you guys in this next cycle that didn't exist in the last cycle.

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

Yes. No, I appreciate it. One thing I'll just -- I just want to sort of go back to our performance this quarter, and I know it's all sort of recovery driven. But I do think posting the industry's best margin very close to breakeven in a quarter that started with very thin demand and very poor pricing. It just underscores the strength of the business and our ability to execute. And so we've got a lot of confidence as we go forward. I think, Dan, we laid out $265 million of cost reduction initiatives that we're well on our way to capturing. And then $300 million of revenue initiatives that we just talked about today.

Some of that was contemplated because we thought maybe the demand environment like past downturns would be a little dampened coming out of COVID as it was in the last 2 big sort of industry downturns. And we wanted to be able to get back to pre-COVID margins irrespective of whether demand was down a bit. If it proves not to be down a bit, that's just more upside for the company. And so I think those 2, $565 million or so of improvement to the business over the next few years relative to our pre-COVID baseline, that's what's going to drive this ultimately. We've got a great product. We have phenomenal employees, great customer service. We're on a good part of the country, a growing part of the country. So we're excited for things to stabilize, like Ben said, normalized business, get back out there, and we're ready for the recovery.

Daniel J. McKenzie - *Seaport Research Partners - Research Analyst*

Understood. Second question here. One of the industry's strongest balance sheet, how are you thinking about using that in the next cycle? Is capital returns on the table sooner rather than later? Or does it make sense potentially to accelerate -- further accelerate some of the fleet replacement retirement, upgauge to more efficient aircraft? How are you thinking about that balance sheet?

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

Dan, it's Nat. Thanks for the question. I think from the balance sheet perspective, as Ben and Shane said, we're in pretty good shape from our historical debt-to-cap measures. We've got a $425 million facility we'll look to repay in the next 90 days or so. And then I think going forward, it becomes a dilemma against repaying other debt, which really, in our situation, has pretty cheap rates, further investment in our business, and then, as you know, we've got the restriction on shareholder repayment until the end of September next year due to some of the government aid. So we'll balance all 3 of those things as we move forward.

Operator

The next question will come from Ravi Shanker with Morgan Stanley.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

So maybe kind of a follow-up to that question and maybe this also links to the revenue initiatives. But just how far paced are you willing -- off paced are you willing to go kind of with some of the new revenue initiatives and kind of deploying that balance sheet kind of -- are you looking at just sticking to the existing mousetrap and try to maximize opportunity? Or are you looking at completely different things?

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

This is on the revenue initiatives. Ravi, I think most of it is stuff that you would expect -- and Andrew mentioned and he can jump in again, but a new RM system, which ours was 20 years old, and we're excited to have the new one in place. There's a few things. I mean they're just -- they're not super exciting to talk about, but distributing our premium economy cabin, indirect channels, we only distributed prior in direct channels. The American, oneworld, WCIA stuff, those are all sort of on the list of things that are going to contribute. I don't think we want to talk a whole lot about things that are new that we might be looking at or different today. But as we get closer to an investor event, we'll lay out sort of more clarity on all of these areas.

Ravi Shanker - *Morgan Stanley, Research Division - Executive Director*

Got it. I think you guys are doing a really good job of ramping up the excitement here. So looking forward to that. And maybe as a follow-up, kind of how would you describe the competitive environment out there right now? I mean, clearly, there's a lot of demand still concentrated in relatively narrow regions and there's a lot of capacity kind of going into that region. So how do you characterize the pricing environment this year?

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

Ravi, I'll start and then I'll have Andrew jump in. I think we always expect competition in our markets. The West Coast, they're very competitive markets. Our mindset, again, as you see from where we were last year, how we brought back capacity, it's always been in a disciplined prudent approach. And I think that's the approach we're going to take. We have dry powder. We can scale it up or scale it back. We have a strong regional airline, Horizon, that was just fantastic throughout this pandemic to fill in a lot of holes. So our view is just, again, a disciplined measured approach over the next 12 and 18 months. Andrew, anything? Does that make sense?

Operator

The next question will come from Conor Cunningham with MKM Partners.

Conor T. Cunningham - *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

The revenue stuff's great. I did have a question and I feel like you guys get basically every quarter. I mean there's been a big push from a premium perspective but from other carriers, and you had some recent changes in JFK. So it seems somewhat topical. With your focus just on higher-yielding passengers and corporate in general, has there been any reconsideration on revisiting the product in terms of dedicating more space to premium products or maybe even moving towards a lie flat seat?

I would just imagine that corporates are asking for again. And the reason why I bring it up is you mentioned this A320 subset of aircraft, it seems like you could test something like that there. I know you have money -- I know that will cost money, but it seems like you have the balance sheet to do it. Just curious on your thoughts.

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

Conor, it's Andrew. A couple of quick things. Just to be clear on the LA movement. We just redistributed JFK slots across the rest of our network. We're still in Newark. So we still fly to New York City from LA. We've just reallocated those. I think on the product side, of course, like we're always looking at product. But I think we've got 12 and 16 seats in the front cabin. And if we did lie flat, it would probably still be 12 and 16 seats. But we have big airplanes to fill. So I think where we're at right now is just to get back in the recovery stage. We still feel really good about our front cabin product that we continue to improve. We have the best pitch in the industry on traditional seats, bar none. And then our premium class cabin is also very generous. And I think a big thing for corporates, too, is our network utility. And I did touch on network, and I will say, we've done a lot of expansion on breadth over the years. We're going to focus more on depth, frequency.

Conor T. Cunningham - *MKM Partners LLC, Research Division - Executive Director & Senior Travel Analyst*

Okay. Great. And then on the American partnership. So I've been thinking a little bit about this a little bit more. But are you expecting your customers to build points and loyalty on your network and then burn them on American's or maybe it's vice versa? Or does that even matter? I'm just curious like how that dynamic may play out when that starts to really ramp?

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

I think we have a lot of experience with this actually. We've had big relationships for decades. And I think at the end of the day, the customers will choose where they redeem and accrue miles under individual programs. And again, we just feel really confident and good about our West Coast network and footprint. And American has a big national and global footprint, and I think they work very well together. And I think both customers of Advantage and Mileage Plan are going to get a lot of opportunity in choice.

Operator

The next question will come from Mike Linenberg with Deutsche Bank.

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

Shane, just a quick one right here. As best as I can tell, it seems like you're in the best position to get back to investment grade next. Is it a stated objective of the company to get to an IG rating? Where are you on that?

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

It's a stated annoyance that we're not an IG company. But yes. No, Mike, it's -- Nat and I are going to be talking about this. We need to go back in that direction. And it's -- we've got to figure out how to engage the agencies differently. But it's probably a ways away as they ultimately make all those decisions. But yes, we haven't publicly put it out there, but we certainly want to get there over time.

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

Yes. Look, the reason why I bring it out is there's a lot of carriers that they will tell you that they want to get back to investment grade-like metrics, and then they'll go out and lever up an airplane and borrow at a single A credit. But never actually really do the work that they need to do on their balance sheet. And so it does instill a level of discipline that I think many of us are hats off to a carrier like Delta who wants to get to the IG rating. So I'm just throwing it out there.

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

Got it.

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

Then just a second question here to Andrew. Andrew, you guys have done a fantastic job. I mean, I don't want to beat a dead horse on this revenue. But when I think about the fact that your entire carrier relies disproportionately on coastal hubs, which have underperformed a lot of the Mid-Con hubs. So you're already starting from a difficult position revenue-wise. And yet, you're right up there among the best in the industry.

Now I know you threw out -- you made the comment that there's been recalibration to the network. You talked about 50 net new city pairs. I'm curious how much of the revenue improvement is just a function of withdrawing from those markets that were underperforming. So I know you gave us a net number, but is there anything that you can give us to give us a sense of what markets that maybe you backed away from that just, they weren't working? And I know you mentioned like depth over breadth and doubling down on Seattle. So maybe I'm answering your question. It's a combination of all of that. But any additional color on that front would be great.

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

And every CEO, Ben and before, have held this strong belief. And I'm just going to be very transparent with you on this one is, it's loyalty. I will tell you that never in my career, when you look at your network and specifically your areas of strength and there's unlimited seats given demand. And when you look at the T-100 data, and you see your load factors compared to your competitors' load factors. When there's unlimited seats to choose from, and you see your loads on multiples, you know loyalty is powerful. And I'm just going to be transparent, moving networks around is good, it's needed. But the strength of our loyalty and our guests and their commitment to us and what we hope to continue to invest in them on service, loyalty program and meeting their needs has just proven to be very, very strong for us.

Operator

The final question is from Myles Walton with UBS.

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

I was hoping you could just clarify, I think you said 4Q you hope the mainline CASMex would be in line with 2019. Can you give us color on regional? And then on the fleet side, that 8% higher 2022 potentially is the exercise, is that similar to the number in the fleet as well, 8% higher than where you were? Or are you getting there through still down relative to the prior fleet levels?

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

Yes. So Nat, you can maybe close the fleet levels. The 8% that is really enabled primarily by the reactivation of these Airbus for a short additional period of time. I just don't have the fleet count in my head for next year. And then on Q4, I just want to make sure we got it right, Myles. We're talking about December exit rate really focused on mainline getting to very close within a few points of pre-COVID unit costs. And I think we don't expect to have pre-COVID mainline capacity back yet. Regional side is a little bumpy, the sort of very rapid regrowth and hiring of pilots around the industry puts a little bit more pressure on both the ability to deploy capacity on the regional side and also needing to get out and start the hiring for the funnel for regional sooner.

So we're still working through that. Those numbers in terms of how many pilots airlines are going to hire have been changing a bunch. But that's going to be a headwind for the regional side of the business for a little bit here.

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

Myles, on the aircraft side, we've got -- net 2022 is a big delivery year for us with 31 737-9s coming in, 13 regional jets as well. And so as we look forward with that and then start to phase out the A320s, we think those are all gone by the end of 2023 and with more 737-9s coming in there, too. So you've got some replacement naturally that's going to happen and then some growth as well.

Operator

And at this time, there are no further questions. I would like to turn the conference over to Ben Minicucci for any closing comments.

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

Well, thank you so much for everyone joining us this morning, and we'll talk to all of you soon. Thank you so much.

Operator

Thank you for participating in today's conference call. The call will be available for future playback at alaskaair.com. Ladies and gentlemen, you may all disconnect.