FINAL TRANSCRIPT

Thomson StreetEvents℠

IAG.L - Half Year 2011 International Consolidated Airlines Group Earnings Conference Call

Event Date/Time: Jul. 29. 2011 / 8:00AM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Willie Walsh
IAG Group - Chief Executive

Enrique Dupuy
IAG Group - CFO

Rafael Sanchez-Lozano
Iberia - CEO

Keith Williams
British Airways - CEO

CONFERENCE CALL PARTICIPANTS

Stephen Furlong
Davy Stockbrokers - Analyst

Jarrod Castle
UBS - Analyst

Tim Marshall
UBS - Analyst

Edward Standford
Oriel Securities - Analyst

Andrew Lobbenberg
RBS - Analyst

Geoff van Klaveren
Deutsche Bank - Analyst

Peter Hyde
Liberum Capital - Analyst

Neil Glynn
Credit Suisse - Analyst

Andrew Light
Citi - Analyst

Penny Butcher
Morgan Stanley - Analyst

David Fintzen
Barclays Capital - Analyst

Jonathan Wober
Societe Generale - Analyst

Juan Ros
BBVA Research - Analyst

Robin Byde
HSBC - Analyst

PRESENTATION

Operator

Good morning, good afternoon, thank you for standing by. At this time all participants are in a listen-only mode. After the presentation we will conduct a question and answer session. (Operator Instructions). Today's conference is being recorded. If you have any objections you may disconnect at this time.

Now we'll turn the meeting over to Mr. Willie Walsh. Please go ahead, sir.

Willie Walsh - *IAG Group - Chief Executive*

Thank you. Good morning, everyone, and thank you for taking the time to join us to discuss IAG's half-year results with a particular focus on our second quarter. With me today is Enrique Dupuy our CFO; Rafael Sanchez-Lozano, the CEO of Iberia; Keith Williams, CEO of British Airways.

Enrique will take you through a presentation on the results and then we'll give you an opportunity for questions at the end, so over to you Enrique.

Enrique Dupuy - *IAG Group - CFO*

Good morning, everybody. So I am going to go through the presentation on the second quarter results of IAG Group. Basically on page two we are showing this very strong, I would say, performance both on the revenue side and on the cost side. So -- and on the revenue side we can highlight revenues, total revenues were up 20% despite certain, I would say, currency headwind.

The passenger unit revenues were up more than 9%. We'll go through these, I would say, revenue performance later on, but basically a strong message having to do with our premium demand continuing to grow in -- through all our main strategic markets, and especially in the long haul.

Very significant to mention is a positive performance on non-fuel unit costs, which have been down 5.8% in this second quarter. And they have quasi-totally offset the increase in fuel prices that as you will see have gone up 32% in absolute terms and around 20% in the unit cost terms.

So coming to the second -- the next page, page three we are there summarizing the headlines of our profit and loss account, which is showing an operating profit pre-exceptional items -- and we'll go through these exceptional item issues in a couple of minutes -- of EUR190m which compare very favorably with the last year second quarter losses, operating losses, of EUR71m.

So the way this huge significant improvement has been generated has to do, of course, on this strong revenue performance 20.2%, having to do with a very negative impact of the fuel cost 32%. But a very favorable performance again in the non-fuel cost side. So EBITDAR has been growing by more than EUR260m. And pre-tax profit has been also growing very significantly by nearly EUR290m.

So, let's go to the next page and I'll try to explain you what's about this I would say, exceptional accounting treatment that has to do with merger accounting on, I would say, the acquisition of Iberia by IAG. So, at the time of the acquisition Iberia was holding some fuel hedges and currency, foreign exchange currency hedges, in its balance sheet with a considerable, I would say, value embedded. So the way IFRS3 works is that the acquirer will acquire the assets and its embedded value, but it won't be acquiring its reserves.

So, the individual accounts for Iberia for the first half would basically recover the value of these hedges, fuel hedges, through their individual profit and loss account. So in the Iberia individual profit and loss account the net fuel costs reflects, I would say, basically how the hedges have been effective, have been creating cash and reducing the fuel bill, I would say, burden for Iberia accounts.

The way the consolidated IAG accounts are constructed is asymmetrical. So, IAG in its Group accounts cannot recognize the value of the hedges as unwinding and being part of the Group profit and loss account. So this asymmetric treatment has, I would say, no cash impact at all and has no impact in the real fuel cost of the Group that are basically having to do with, I would say, the gross cost and the effectiveness of the hedges.

So, if we go to the next, I would say, slide we are now focusing on unit revenue summary and trying to understand how this significant revenue growth has been reached. So, on a passenger side revenues have been growing by 22%, cargo revenues have been growing by 9.4% and the total the previously mentioned figure of 20.2%.

The way these figures are built have to do with this capacity increase of 11.7% compounded with a unit revenue performance of 9.4%. So this 9.4% is in itself also generated through a very significant improvement on our load factors, on our seat factors that accounts for 2.7 percentage points, and also by a powerful evolution of our yields.

Have to take into account also that because of the weakness of the dollar against last year there is a certain, I would say, currency headwind in, specifically in, passenger and cargo unit revenues which basically accounts for 3.2% negative in the case of passenger, and in the case of cargo it reaches 4.5%.

So this, I would say, very significant improvement is basically supported on one side, on the comparables with second quarter last year which, I would say had some clear, I would say, disruptions having to do with the ash cloud, and with strikes at British Airways. But it's also recognizing a significant underlying recovery in our main, revenue trends, which we estimate in the range of, representing 70% of the total improvement.

If we go to the next page, which basically is showing how the passenger unit revenue on a 12=month rolling basis have been evolving through the last quarter. So, what we recognize now is we are, near or even slightly above, I would say, peak levels of the first quarter of year 2009. But also I would say, considering that we have some differences that I would like to highlight, against, this last peak position.

So the underlying demand in our main market in this location is stronger. And this demand outlook is firmer than we -- the one that was basically envisaged at that point in time. Our challenge now is, therefore, to maintain this upward revenue momentum in the second half. And basically upon, I would say, a situation where our fuel hedges will be gradually unwinding through the next quarters. And if market prices remain as high as they are together -- today, they will basically be increasing our net, I would say, fuel cost through the next quarters.

So coming to the next slide which basically will be showing how these significant passenger revenue improvements especially in unit revenues has been split through our different network regions. So what we recognize is a strong revenue growth across all regions, helped in some cases by the comparisons with the disruptive period last year.

We have to mention also the way the increase in stage length that we are experiencing because of the adjustments in our short- and medium-haul networks and the increases that we have been producing in capacity in our long-haul networks, are basically changing the mix, and as you know then is pushing downwards mathematically the average of our unit revenues. So this sector length increase is representing in this quarter something in the range of 6.2%.

In general, London market seems to be a market that is avoiding some of the wider negative macro trends, as we also recognized in Q1. But at the same time we have to confirm that unfortunately Madrid is not able to escape the weak Spanish economic environment, and a very high level of tough competition.

On the long haul the improvements in -- on the North Atlantic routes are the most important, given our leadership position there. Latin America has experienced also a very significant capacity improvement there. But because of the way the global capacity is moving unit revenues increases are slow specifically in relative terms to other market areas. There have been also disruptions in North Africa and the Middle East. And these markets basically have been adjusted in terms of the capacity increases, and they are showing the lower level of capacity increases on our long-haul routes.

What we have accounted for in the first half on the area of the events happening in Japan and the Middle East, we are estimating that around EUR50m to EUR60m have been the negative impacts on revenues that we have suffered because of the special events occurring in these specific markets.

So as a whole a very strong pattern of growth in terms of capacity, and unit revenues in the long haul markets across the board, and a specific strong adjustment in the size of our domestic markets, especially in the Spanish Madrid area. So as you can imagine the momentum is set to slow in the second half due to stronger comparables that we will be seeing through the second half of last year.

If we go to the next slide we are considering here basically the behavior of the premium segment of our market. Basically we are continuing to experience a significant improvement as a whole in premium traffic growth. So the blue line represents the change in RPK, so basically related to demand. And the red bars are basically focusing in unit premium revenue performance.

So while the premium yields have been effectively flat year on year there has obviously been a huge volume growth. Some of which is due to bounce-back. But, however, we feel that we are making some strong underlying progress in this segment. And it's not just the premium markets, the long haul, especially the long haul non-premium unit revenues and yields are also moving upwards.

If we go to the next slide, I will just talk briefly on the first months of our transatlantic joint business update. It's still early days for the JBA. We have put in place airline prices, joint scheduling and joint selling. And we are seeing good performance, especially in the London market and the premium segment.

We are now planning our winter capacity schedules based on the development on the demand in the different sectors with our joint business partner American Airlines. I know that you will be all expecting us to give figures on the benefits of the JBA but we are only a few months in, and we will prefer to wait until we see the results of our full seasons, and bookings for the winter season before we give you any performance numbers. But about these early days we are confident and we recognize that the JBA is contributing well. And we are achieving already improvements in our premium market shares.

So if we come now to the cargo business, we have to recognize that the cargo momentum has flattened. Compared with average market growth that you will be able to recognize for the whole first half of year 2011 we have to say we have outperformed the market in terms of volume growth. And maybe we are less exposed to some weakening markets as China and others, and we are more concentrated in markets that are still experiencing some growth momentum. The recovery in the markets was variable as I was -- as I just expressed. But it showed a surprising positive impact, for example, in mainland Europe.

So the cargo market is still suffering and will be still suffering some irrational competition in some specific areas, which together with tougher comparisons will make the coming months more challenging in terms of -- especially in terms of yield. So we are expecting unit revenues in this specific area of business to plateau.

So if we come now to underlying capacity changes by quarter, as you see in the chart is quite difficult to recognize which are the underlying growth patterns through the year through the different quarters, and what's the actual capacity figures, because as you well know the underlying very bumpy disturbance in the base of year 2010.

What we are now seeing is underlying year 2011 growth to be trending to a 4% to 5% planned capacity that would be similar to year 2008 levels. As you see, the next quarter is going to be quite clear in terms of the capacity trends, because last year was also a quite undisturbed period.

The final quarter will be probably a little bit more difficult to analyze. There may be capacity growth up to 6% but the underlying one would be more in the range of 4%. And we are going to monitor closely the behavior through the next months of our strategic markets. And where we feel there is weakness, enough weakness we will be adjusting because we have flexible tools to provoke these adjustments if we feel it is necessary.

In the longer term these charts shown on one side, on the red line, what we would be calling a basic growth scenario and the other two lines would represent scopes and ranges in which we can move basically through early retirements of older fleets and on the contrary the acceleration of the renewal of some of -- through some of the new generation fleet that we have already some contracts on.

So the growth scenario will be based on extending leases, slowing down retirers and exercising purchase options that we have. And we will see through the coming years new deliveries on Iberia and British Airways having to do with 330 aircraft in the case of Iberia, 787s and 380s in the case of British Airways.

The more cautious cost scenario will be based on lease returns, accelerated retirers and contractually allowed postponements of new deliveries. So this shows how flexible our fleet structure can be to adapt ourselves to the new demand patterns that we'll be facing in the different segments of our network.

If we come to the next slide, this is a slide that we have been showing in the last quarter presentation, and it tries to give you a sense of how we feel the trends in our main segments and networks on traffic are showing. So, you can see on our revenue environment chart that we really haven't change very much our messages, except that we have changed the cover -- outlook from stable to what we will be calling plateau.

We want to reiterate that the second half would be tough in terms of comparisons, tougher than the first two quarters of the year with the year 2010. So of course we aim to maintain unit revenue momentum and therefore, if necessary as we just mentioned we'll make further capacity reductions on some areas through the winter.

So changing now to the cost side, the first chart has to do with overall unit operating cost behavior. So on the left hand side of the chart we can see, we can recognize the performance against the first year comparison. So quarter to quarter the second quarter shows a total fuel plus non-fuel behavior performance of only 0.5% improvement. This means a very powerful message related to, we've been able to offset nearly 100% of the fuel cost impact, the negative fuel cost impact through reductions in other costs in other areas of the cost structure of our business.

If we make the comparison on a two-year exercise, and we make it a on a 12-month rolling basis we also recognize that we are now about 2.5% below on a 12-month basis, rolling basis to where we were in year 2009. And this represents a very significant improvement taking into account the inflationary pressures that we are suffering and that we have been suffering through these later months.

So we'll go through on a more detailed comparison on our different lines of costs. In the case of fuel costs we are showing in this chart the bridge chart of how fuel costs have been developing since last year second quarter and then into this year second quarter.

We have a modest increase having to do with volume. After that we have a very significant increase EUR470m have to do with market prices, which has been partially offset because of currency weakness, the dollar and because of the fuel hedges. So the net figure for the second quarter of this year accounts for EUR1.25b. So for the Q2 72% of the consumption was hedged, and the average, I would say, fuel price paid after hedges was $925 per metric tonne of kerosene.

If we go the next chart and how we see the full year, we are still sticking to this EUR5.2b figure for the whole of year 2011. And this assumption has been made at a spot rate for the rest of the year of $1,070 per metric tonne. So we also have these sensitivities of how this final figure would be if the fuel market prices would range for the remaining of the year between EUR600 per metric tonne to EUR1.4 -- EUR1,400 per metric tonne.

So the range of final fuel bill will be between EUR4.8b in the more favorable environment to EUR5.5b. The way the two remaining quarters of the year will be showing is a certain increase from the prevailing EUR1.3b to EUR1.4b which we expect for both Q3 and Q4. On those assumptions we are only -- we are also recognizing the favorable impact in terms of year-to-year comparisons because of a weaker dollar which we are estimating at $1.43 for the rest of the year.

So if we come to the next slide we are here showing the sensitivity that our fuel exposure is having to market prices. So as a whole now we will be showing that if market prices move up or down $10 per metric tonne of kerosene our operating results would be moving by plus minus EUR8m on a relative basis.

Our hedging pattern has been evolving and now we have 67% hedged of the second half, and it splits between 73% for the third quarter and 61% for the fourth quarter. And on a full -- on an 12-month forward basis we are now hedged by 58% of our expected fuel consumption. So the average levels, the average prices of our hedges for the remainder of the year are in the range of $900 to $950 per metric tonne of kerosene.

If we switch now then to the labor costs, we have followed a very similar structure in the pattern of our slide. Again very, very significant improvements in labor costs trough this, I would say, second quarter minus 3.2% if you compare ourselves to the second quarter of last year. So, underlying employee unit costs have been reduced by 4.7%, and this figure then would be excluding something in the range of 16% to 20% restructuring provisioning that has been taking place in British Airways.

So as the whole productivity for the quarter has been improving by 11.7% due to be able to produce about 11.7% more capacity with the same number of, average number, of employees in relation to year 2010 numbers. And if we compare ourselves with year 2009 figures our average employee force would be down about 6.5% against that year 2009 level.

So on the other hand and supplier costs again we have a very positive performance in this quarter, we are down around 7% on the quarter. And we are just at plus 1.1% if we make a 12-month rolling basis comparison. And this has a very specific positive implication because I already mentioned these very strong inflationary pressures in which we are embedded, particularly in some of our key airports including London, Heathrow.

So it is essential that we continue to try and gain these efficiency benefits from our supplier base. And of course as we have been restating in the past this is a key part of our synergy program now and we have to be able to scale it in the future to a larger group and to more ambitious targets.

In terms of ownership unit costs here again we are following the same picture, maybe still more powerful. And it has to do again with the same message, so being able to produce these 11%, 12% capacity increases with the same asset base. So growth has been made out of utilization improvements on our fleet and this has rendered these very significant improvements in the quarter that are also showing in this two-year, 12-month rolling base comparison in which basically we are only showing a unit cost improvement of around 1%.

Of course, these unit ownership costs will increase in the future through the addition of the new fleet in which we are committed. But at the same time we'll be achieving very significant reductions in fuel consumption and maintenance costs that will more than offset the negative implication in our unit ownership costs.

So, as a whole the profit bridge from Q2 through -- Q2 year 2010 to Q2 year 2011 is shown in this chart, in this bridge chart. We are seeing a slightly positive outcome from our currency translation impacts. We see also a very significant improvement out of the disruption that we had to suffer last year, EUR300m around. And then we are seeing a very significant revenue improvement above the disruption one that more than offsets the fuel cost negative impact that we are suffering.

So the basic message here is that through fuel surcharges, through other pricing movements that we have been able to implement through these last months, through our mix improvement and especially the strength of the premium segments of our traffic we have been able to more than offset the fuel cost impact that we have been suffering in the quarter. And then on top of that we have other cost improvements by more than EUR130m for the quarter that has allowed us to reach this EUR531m EBITDAR result for the second quarter.

So, getting now to the balance sheet summary, we can say we maintained a very healthy balance sheet position with low gearing at the June balance sheet date again, so strong operating cash flow has been useful. And working capital performance was balanced in the first half by net CapEx of just above EUR300m.

We are envisaging a CapEx figure of around EUR1b for the whole of year, with debt repayments and two specific flow movements having to do with competition fines, paying -- paid in the quarter by around EUR170m, and this one-off payment to British Airways pension fund in excess of regular contributions that represents nearly EUR160m, and that had to do with the strength of the cash position of British Airways by the end of their last fiscal year March year 2011. So basically this represents a very powerful and strong development through the first half that has enabled us to reduce our gearing to 42%.

If we come finally to the outlook that we are foreseeing we would like basically to mention two main chapters. The first one is related to our synergy targets. We are showing here again a pattern of how we expect our synergy gains and improvements to be materialized through the next years. We have these year 2011 target of -- in the range of EUR70m. We are extremely confident, more than confident that we will be able to achieve and maybe surpass this level of improvements, of synergies for year 2011.

And we feel also very confident of being able to get to the figures that we transmitted to you in the recent past about the year 2015 targets. And we are also confident of being able to give you more precise messages the next time that we meet together in our Investor Day by the beginning of November.

In terms of the rest of the environment in which we are moving, what we can say is that our basic outlook remains unchanged. Our long haul business is stable with still strong performance in the premium segments, especially in this long haul area. We have to restate again that our short haul business remains highly competitive, especially in some areas as, I would say, the Madrid catch-in area. And that the cargo business has -- we feel that has now reached a plateau.

So, we have to recognize that the comparisons through the remainder of the year and second half will be more difficult. The second half of last year was strong. And we also have to recognize that through the next quarters we will continually and gradually unwind and use our fuel hedges.

So this means that if fuel market prices remain high our fuel bill will continue growing. We still will be -- remain very focused in maintaining a strong performance both in unit revenues, especially in the markets in which we are leaders and also in positive performance on our non-fuel cost base. We will be considering some capacity reductions for winter season, and we will monitor closely the markets in which we feel more weakness and that we feel capacity reductions will represent a positive outcome for the Group.

And that's basically all. We are now expecting your questions on these or other matters. Thank you.

Willie Walsh - *IAG Group - Chief Executive*

Okay, thank you. We are ready for questions so who would like to go first?

QUESTIONS AND ANSWERS

Operator

I have questions over the phone, would you like me to open up sir?

Willie Walsh - *IAG Group - Chief Executive*

Yes please.

Operator

Thank you. The first question comes from Mr. Stephen Furlong. Please go ahead your line is open.

Stephen Furlong - *Davy Stockbrokers - Analyst*

Morning, gentlemen. Just a -- could you go through again just so I understand the one-off effects from last year and this year, you're talking about Japan being EUR90m to EUR100m and in the first half EUR50m to EUR60m. Last year obviously with the ash cloud and also the effects of strikes, so you just might -- I just want to see what the comparisons are. Thanks a lot.

Willie Walsh - *IAG Group - Chief Executive*

The figures are all there for you, Stephen. But as Enrique said we are anticipating or expecting total impact of the problems in Japan, the Middle East, North Africa issues to amount to about EUR90m to EUR100m in the full year. And we estimate that we've incurred somewhere in the order of probably just shy of EUR60m in the first half. Of that EUR90m to EUR100m we've encountered about EUR60m, just under EUR60m in the first half of the year.

Stephen Furlong - *Davy Stockbrokers - Analyst*

Okay.

Willie Walsh - *IAG Group - Chief Executive*

Thanks very much, Stephen.

Operator

Thank you. The next question comes from Miss Castle or Mr. Castle, please go ahead your line is open.

Jarrod Castle - *UBS - Analyst*

Good afternoon, gentlemen. It's Jarrod Castle from UBS. Two questions please, there is quite a big difference in this quarter between your yield performance on North Atlantic compared to your partner American Airlines. Their North Atlantic yields were down about 5% for the quarter. Clearly you're showing very good momentum. Going forward would we expect kind of more similarity between what they report and yourselves?

And secondly, how much more do you think you can actually do on the non-fuel cost side? Are there still many more initiatives you can put into place or is that also going to start to slow a little bit? Thank you.

Willie Walsh - *IAG Group - Chief Executive*

On the North Atlantic performance I think what you've got to realize is that the American network would include a significant element of Europe to North America whereas our network is primarily, not solely but primarily, a London to North America. We do have a small proportion of our business is Madrid to North America. But by far the biggest part of the business is London to North America.

And as we've said in the presentation what's clear to us at this stage is that London is a stronger market. And I think that's true of the past number of years. So where we've heard a number of our competitors, and indeed our partner, talk about some capacity and demand issues I think that relates more to the general European market than it does to the specific markets that we operate in and markets that BA are traditionally very strong in.

So, we are very pleased with our individual elements of our transatlantic business, but equally we're pleased with the performance of the JBA. It is early days, as Enrique said, but the early indications remain positive. It's clear to us that a strong part of our performance is down to the premium demand and our success in that market in gaining market share and I expect that to continue as we go through the year.

In relation to non-fuel costs, our view is there's always a little bit more that you can do. There's no question that it does get harder, but we're always looking for opportunities to reduce costs or certainly, at a minimum, to try to minimize the impact of the inflationary aspects of cost increases in a number of areas.

So I think this is an area where we've clearly had a lot of success in the past and will be a continuing area of focus for us, but I don't think you can ever say that the job is done there. It is hard work, it gets harder having achieved the successes that we have, but clearly we will continue to focus on it.

Enrique Dupuy - *IAG Group - CFO*

To add a little bit on what Willie said, I guess that the potential on future non-fuel cost improvements will be basically related to the implementation of our synergy program. So, as you know, this synergy program will be creating improvements in both revenues and costs through time and through the next months, especially the next years, we are going to be achieving significant improvement due to the implementation of these cost synergy measures that we are now defining and planning.

Jarrod Castle - *UBS - Analyst*

Okay, thank you very much.

Operator

Thank you, the next question comes from Tim Marshall. Please go ahead, your line is open.

Tim Marshall - *UBS - Analyst*

Hello, everybody. There's clearly a big difference in the first half of the year between British Airways and Iberia and I guess British Airways looks like it's bridged much of the gap between the worst of it and the previous peaks, at least in terms of margins. So how should I think about where BA's placed now in relation to the previous 8% to 12% margin target?

And if I can then come onto Iberia, clearly there are both underlying demand issues but also structural, I guess maybe here on the short-haul side of things, issues on the structural side. So how much of each of those two issues is leaving Iberia so much behind BA in terms of the shape of recover?

Willie Walsh - *IAG Group - Chief Executive*

I don't think the recovery is any surprise, it shouldn't be any surprise to anyone, we always at British Airways considered that BA would recover faster from the general economic downturn because of both the nature of that, as you know triggered by financial services, and also the particular markets that we operate in. So certainly we're not surprised at the difference in performance that was expected. I think disappointing the general environment in the Spanish economy, that's clearly something that we can't do anything about and it's probably weaker because of the general weakness of European and euro economies.

So there are some structural issues that you quite rightly highlighted and they're some issues that we intend to tackle in the months and year ahead. We've got plans drawn up, we're finalizing some of these as to how we do that, so it's clear to us that there are opportunities for us to address some of the structural cost issues that exist within Iberia, but also we're very confident about the market to Latin America, where Iberia has a strong presence.

There's been a lot of competition in that market, a lot of capacity has gone into the market in recent times and I think that's evidenced by not just what we're showing in terms of capacity and unit revenue performance in Latin America, but also what our competitors have been reporting there. So that's part of the dynamic that we're witnessing at the moment.

But there are structural issues that we need to address and structural issues that we will address and that, clearly, is an opportunity in terms of the performance. And in relation to where we see the combined business going longer term, clearly that's a subject that we will focus on in our November Investor Day presentations to you.

Tim Marshall - *UBS - Analyst*

I'll look forward to that a lot then. Thanks, Willie.

Operator

Thank you. The next question comes from Mr. Edward Standford. Please go ahead, your line is open.

Edward Standford - *Oriel Securities - Analyst*

Good morning, everybody. You talk a lot about tougher comps going forward into the second half, how would you judge the pricing power you have to recover continuing increases into your price, which seems to be in order?

And secondly, could you just give an -- talking about the structural issues to be dealt with, could you give an update on how the outsourcing of the flights to Vueling has gone and whether that's give you any food for thought about how you might continue with that going forward? Thank you.

Willie Walsh - *IAG Group - Chief Executive*

Our pricing really is something we look at on almost a route basis, but certainly on a market basis and we clearly have pricing power in certain segments, so it's much easier in the current environment to recover some of the fuel price increase in the premium, and long-haul premium in particular, where demand has been particularly strong and where we're doing well. It's more difficult in the non-premium markets.

I think that's true of the UK and Spain, the UK has the added disadvantage of high airport and passenger taxes, the APD, so that's clearly made your recovery of the fuel costs more difficult and I think this greater awareness of those APD charges. So we've been able to recover elements of the fuel costs increase, as we had indicated previously, around 50% but we see that the ability to recover as we go into the fourth quarter, in particular, will be more difficult.

On the use of Vueling, yes, that's gone well for us but we don't see that as a structural solution to the particular issues we have with the short/medium haul operation of Iberia. Vueling is a low-cost, no frills operator, it doesn't provide us with the sort of connectivity that we particularly need on the network. It works well on some routes where the volumes of transfer passengers are low and, particularly the volumes of premium transfer passengers are low.

So it's part of the solution but it's not the solution and we've continued to look at all of the opportunities, and I would describe it as an opportunity, I think there's -- even going back to the earlier question about non-fuel costs, this is clearly an area of opportunity for us where we see a structural cost issue. We've shown our determination to deal with these issues in the past and you should expect us to deal with them in the future as well. So Vueling has worked well but we don't see it, definitely not at this stage anyway, we don't see it as necessarily the permanent solution to the issues that we have there.

Edward Standford - *Oriel Securities - Analyst*

Thanks very much.

Operator

Thank you. The next question comes from Mr. Andrew Lobbenberg. Please go ahead, your line is open.

Andrew Lobbenberg - *RBS - Analyst*

Oh hi, guys. It's Andrew here at RBS. I just want to stay on the issue of the outsourcing to Vueling. At this stage are we expecting this cooperation to continue into the winter and how are relations with SEPLA, with the Spanish pilots? How great is there a risk of industrial action?

And then also I'd be curious to hear, on the BA side, what the temperature is like on industrial relations there? Obviously the cabin crew are settled, but we're seeing quite a lot of volatility from pilots at Virgin, at FlyBe, there've been some tensions at EasyJet. They've given you a lot of support through the cabin crew disputes so how do you see relations there?

And, if I can be greedy, any update on LAN and its partnership with TAM and your aspirations to maintain a partnership in Oneworld with them?

Willie Walsh - *IAG Group - Chief Executive*

Winter with Vueling, yes, probably will continue, as I said it's worked well with the capacity that we transferred in there, so that will continue through to the end of March and we'll review that for coming seasons as well.

In terms of the industrial relations with SEPLA, there have been clear tensions obvious in the Spanish press for some considerable time, but that's something that we will deal with, it's not going to deter us from tackling the structural issues that we have to tackle. So we're not in any way distracted by these noises in the background.

I would describe the industrial relations position in BA to be extremely good and we've achieved the restructuring that we needed to achieve. We've got agreement with pretty much all of our negotiating groups. I think the final one is actually balloting at the moment for the latest pay deal, which is in line with the other ones that we've announced. So I don't see any issues there, I'm sorry that my competitors are having difficulties with some trade unions, so we have sympathy for their position but we're doing okay.

And LAN, we remain confident that the right alliance for LAN is Oneworld. Our confidence stems from the strength of Miami as a hub, where American, BA and Iberia are all strong and it's very important to LAN, and our position in Madrid, which is equally important to LAN.

So when you look at what Oneworld can do for LAN, it's clear that it has done a lot and will continue to do a lot and we're talking to them in terms of what we can do for the development of the relationship. But they're clearly focused on getting the regulatory approval for their merger with TAM and, from everything I've read, that's a complex and ongoing situation and it's clearly the thing that is foremost on their minds at the moment. But we'll stay close to LAN and we'll continue to work with them as a strong and important member of the Oneworld alliance.

Andrew Lobbenberg - *RBS - Analyst*

Cool, thank you.

Willie Walsh - *IAG Group - Chief Executive*

Thanks, Andrew.

Operator

Thank you. The next question comes from Geoff van Klaveren. Please go ahead, your line is open.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Hi, good morning. It's Geoff from Deutsche Bank, three questions please. First is on Gatwick, I guess your other strategic short-haul problem, with fuel prices high is this becoming more of a problem for you, any thoughts on restructuring Gatwick's short haul?

Second question is connecting traffic, how's that performing?

And the third question is on the volcanic ash. Were you satisfied with the response this year from the authorities, is this a declining risk going forward in terms of if there is another eruption does it mean less disruption going forward?

Willie Walsh - *IAG Group - Chief Executive*

Gatwick, I don't think Gatwick is a strategic issue. We've got a small but relatively important short-haul position at Gatwick, around 20 aircraft. We've got opportunities to improve the performance there. [Call space] has done well and the challenge for us is the profitability, which clearly has not been in line with what we expect. But it's an area of the business that we're looking at, but it's not a huge issue for us and we'll deal with that in due course.

On connecting traffic we've seen good performance at both of our main bases, so don't see any issues there. As you know, we can flex the amount of transfer traffic that we have. We've got strong point-to-point demand out of Heathrow at the moment, there's strong demand out of Latin America into Madrid. The T5 hub is working extremely well, the Madrid T4 airport terminal is excellent, but the performance of the Barajas hub has been impacted by ATC issues, largely, which is outside the control of

Iberia and is impacting on all airlines' performance at Madrid, so that's something that we want to see the Government and Aena deal with. But it's not a major issue for us at the moment. So overall there we've no issues.

On volcanic ash, volcanic ash we deal with on a daily basis, we've got active volcanoes in different parts of the world today. Am I satisfied with the response of the regulators in the UK and Europe? Absolutely not, I think we dodged a bullet because the volcano eruption ceased, but what we need to see is the politicians back out of this issue and leave it to the experts who deal with this.

We deal with volcanic ash in every other part of the world with no interference from politicians, Europe seems to operate in a completely different environment and, quite honestly, the interference of politics is unhelpful both from an operational point of view but more important, I would argue, from a safety point of view. Because these are people who don't understand how the safety regime operates within the airline industry, how we asses risk, which we do on a daily basis, how we've done extremely well assessing the risk of volcanic ash and how we can continue to do so.

So I'm pleased that there's greater awareness, I'm optimistic, actually, that we are moving towards a better environment, but we were fortunate that the volcano ceased erupting earlier this year and fortunate that the weather patterns largely kept it away from the UK and Europe. And it's not just a UK issue, by the way, so my criticism is not of politics in the UK, it's more of politics in Europe, but we need to continue as an industry to move to a more sensible regime than Europe and move to the regime that exists in every other part of the world and operates safely and properly in every other part of the world.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay thanks. Sorry, just a quick follow-up, on the ATC at Madrid I was under the impression this issue was solved, is this -- yes, how many strikes have there been in the last few --?

Willie Walsh - *IAG Group - Chief Executive*

No, there haven't been strikes, it's just poor ATC performance.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay, got it.

Willie Walsh - *IAG Group - Chief Executive*

I'm sure any of you who have flown into Madrid will have probably encountered, in some cases, short delays, but the overall performance of Madrid airport has been impacted by the ATC environment at the airport and the ATC environment in Spain in general.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay, understood. Thanks very much, Willie and Enrique, thanks.

Operator

Thank you. The next question comes from Mr. Peter Hyde. Please go ahead, your line is open.

Peter Hyde - *Liberum Capital - Analyst*

Thanks. Could I just look at premium? I don't need to go back to slide eight but on premium traffic you're driving volume as much as anything else. How far can you go in terms of driving volume in premium, I suppose is one question?

Secondly, I don't know, just very quickly, if you've got a percentage of what connecting traffic is for IAG, but I'd be interested in that.

And then thirdly, can you just talk a bit more about employee costs? I think you said there was a provision in there for EUR16m of restructuring at British Airways. Is there any bonus accrual provision in there or any other one-offs? Thanks.

Willie Walsh - *IAG Group - Chief Executive*

Yes, on premium I would say that the limitation is the number of seats in the premium cabin and we're not full on a network basis, there are parts of our route network that have very high seat factors in the premium cabins, but there is still scope for us to grow premium volumes. And we're comfortable that we've got sufficient capacity to deal with the demand and the demand growth that we're witnessing at the moment.

But it's clearly an area of our business that has performed very well and I think it's an area of our business that is outperforming the market, certainly from the statistics that we've seen from IATA, both on a global and a regional basis where we're clearly doing better than the market and that is encouraging. I think it reflects the strength of our network and also the strength of our products. So there's still some upside in terms of volume.

August will be -- you won't see the same sort of performance in August, because clearly August is not a strong business month and it's clear from the premium growth that we've witnessed that the main driver behind the premium growth this time is business traffic. In the past we've talked about premium leisure, but I think the main driver behind the growth in the premium cabins has been what I would call genuine business travel. So the outlook there, from everything we see in terms of the admittedly limited visibility, remains positive.

On transfer, on an IAG basis it's probably around 50% of our total traffic is transfer traffic. Clearly it's a higher proportion of Iberia than it is of British Airways, but it's about 50%, slightly over 50%.

And on the provisions, yes there is a provision in the results for a bonus payment -- I'm sorry and restructuring yes. So I think we highlighted the restructuring but there is a bonus payment provision there as well.

Peter Hyde - *Liberum Capital - Analyst*

Okay, thanks. Could I ask just one -- sorry, very one last question on stage length. You talked about plus 6.2% because of the mix impact. How does that rollout over the next 6 to 12 months?

Willie Walsh - *IAG Group - Chief Executive*

You're not going to see a major change; obviously it's primarily but not solely Iberia where we've been cutting the domestic capacity -- domestic and short haul and growing the long-haul network. So it will be a feature of the figures in the second half as well as that reduction in domestic continues to flow through. But it's -- beyond that -- it's largely then, beyond this year, you're not going to see a major change in it.

Peter Hyde - *Liberum Capital - Analyst*

Okay, thanks.

Operator

Thank you. The next question comes from Neil Glynn. Please go ahead, your line is open.

Neil Glynn - *Credit Suisse - Analyst*

Good morning, gentlemen. Thanks for taking the questions, just two from me please. The first, just to harp back to the initial question, I think, on American Airlines, it seems to me certainly consensual that its revenue management maybe lags peers in the US. You've mentioned in terms of its exposure to Europe as to why its yields may be inferior to your own, but can you answer the question as to whether its yield management practices actually are a weakness or, to ask another way, whether that can actually be improved on and consequently help the JBA?

And then second of all, I'm just interested, in terms of Heathrow, yields are obviously strong in premium but is there a distinct difference or not between inbound yields and outbound yields in premium?

Willie Walsh - *IAG Group - Chief Executive*

On American I think we're all learning from one another, actually, on this. There are aspects of the American yield revenue management that actually are quite good, they've done some interesting things that BA and Iberia can benefit from and clearly they can benefit from some of things BA and Iberia. I think the main difference is I think BA has traditionally been stronger when it comes to yield and revenue management in the premium part of the aircraft and maybe American has been better at yield and revenue management in the non-premium and I'd have to see that as an opportunity for the joint business.

So I wouldn't say that their performance is down to something that's internal, I think it just reflects the general environment in Europe and I think it's probably consistent with what some of our European peers have been reporting in recent time. Certainly the language being used by Air France, Delta, the SkyTeam Alliance would seem to indicate that they're finding it difficult in that part of the market.

In terms of Heathrow, we don't actually give you any breakdown and I'm not going to start giving you a breakdown on yield performance in and out. What I would say is that it's not -- there isn't an asymmetric performance there, we haven't seen a change in inbound to outbound at Heathrow. The patterns that we would have witnessed over the last few years continue, so it's not a particular issue just about London outbound, it is that London both in and out I think is doing well at the moment I think is doing well at the moment and it'd clearly doing better than the rest of the UK.

And I think that's consistent with what you'll hear from other businesses. It's certainly consistent with what I've heard from other business leaders where they're seeing the London parts of their businesses doing well and regional UK doing not so well. London has always performed more strongly, but I think there is a growing disconnect between London and the rest of the UK economy.

Neil Glynn - *Credit Suisse - Analyst*

Great, thanks, Willie. If I can just ask Enrique as a follow-up, can you give us some guidance on CapEx for FY12 or is it still a little early?

Enrique Dupuy - *IAG Group - CFO*

Well, I have to say it's still a little bit early. We want to give you a full presentation on CapEx and financial structures by the Investor Day, beginning of November. So if you are so kind to have some patience I will be able to provide you a clear picture at that moment in time. What I can say as an advance is that we are feeling comfortable about the balance between the free cash flow that IAG Group will be able to generate and the CapEx type of requirement that we are envisaging.

Neil Glynn - *Credit Suisse - Analyst*

Great, thank you.

Operator

Thank you. The next question comes from Mr. Andrew Light. Please go ahead.

Andrew Light - *Citi - Analyst*

Oh hi, good morning, just three quick questions. One, you say you're considering capacity reductions in Q4, is that actual reduction negative or is that just somewhere less than 6% and can you give me an idea of where those softer markets are?

Secondly, there's been a challenge, I think from the BA pensioners on the switch from RPI to CPI indexation. How watertight is your case from a legal point of view?

And then thirdly, in the notes you referred to an FX gain, the operating level of about EUR47m in the first half. Roughly how much of that was in the second quarter? Thank you.

Willie Walsh - *IAG Group - Chief Executive*

On the capacity, what we're saying in the fourth quarter is we're still forecasting growth in overall capacity but that we've shown already that the Q4 plan for capacity, which had been I think 7.6% we're now showing at 6%, and this reflects some frequency reduction and, quite honestly, we're very comfortable with what we have seen so far. We're pleased to see some of our competitors take capacity out and it will be in light of what we see them doing that we'll finalize our capacity plans. But at the moment the planned capacity that we have for Q4 is something that we're -- I have to say at this point we're comfortable with, but we're always looking for opportunities to prune it if we think that makes sense and we'll continue to work on that over the next couple of months.

On BA pensions I think the issue as for the trustees and I think the trustees were very clear, certainly from what I've read in the paper about the position, which I think was best summed up by the difference between what you'd like to have and what you're entitled to have. So the trustees clearly have a responsibility to ensure that the scheme is run with the benefit of all of the members of the scheme in mind and our understanding is that it would require a change in the rules of the scheme to facilitate some of the demands of the pensioners.

And in relation to FX, I think it was EUR27m?

Enrique Dupuy - *IAG Group - CFO*

Yes, exactly. We mentioned for the second quarter a EUR27m positive impact. Of course remember it has to do with a short position that the Group has in dollar terms because of a weakness of the dollar in relation with last year we are getting near a positive net impact. The second FX impact that we care about is of the sterling translation into euros, but in that specific case impact has been very calibrated and balanced between revenue impact and cost impact, so the net is clearly minimal near zero. But it appears has been generated more revenues and then more costs coming from British Airways turnings translated into euros.

Andrew Light - *Citi - Analyst*

Can I just follow-up, thank you, on the capacity reduction and is any of that taking place on the North Atlantic?

Enrique Dupuy - *IAG Group - CFO*

No.

Andrew Light - *Citi - Analyst*

Thank you.

Operator

Thank you. The next question comes from Penny Butcher. Please go ahead.

Penny Butcher - *Morgan Stanley - Analyst*

Good morning, thank you, I have two questions. The first is in relation to the Spanish domestic market, I note that you mentioned in the slide presentation that is probably one of the weaker areas of yield for the Group. Earlier this week your subsidiary business, Vueling, actually said that the pricing environment for the domestic Spanish market had seen a turnaround, perhaps around June timeframe and certainly into July to more positive year-on-year growth in terms of average fares. Would you be able to comment as to whether Iberia has seen some of that benefit coming into the third quarter?

And my second question relates to the labor issues within the Spanish domestic market. I just wanted to clarify, certainly from speaking to the pilot's side of the equation the SEPLA group, they seem to think there are scope clauses that would not allow IAG or Iberia to transfer a lot more flights through to the subsidiary businesses than you currently have done. Can you clarify whether that's correct or whether you do have room to, potentially, push more aircraft into those subsidiary businesses? Thanks.

Willie Walsh - *IAG Group - Chief Executive*

Okay, in relation to Vueling we're a 46% shareholder in Vueling. I think the comments they've made and, I'll be honest with you, I've not had any discussion with the Vueling management, but when they talk about revenue environment we've all seen revenue environment improve, the problem is that it's not improving enough to cover the increase in the costs of oil. So I think we need to look at both sides of the equation here.

What we're seeing is a significant increase in oil price, we need to see a much more significant increase in pricing to be able to offset that fuel price increase and I think that's the challenge for the industry. So while, if you look at our figures, we've reported unit revenue increases and pretty healthy unit revenue increases, and that's across the board. In some parts of our business it is not enough to offset the unit fuel costs increase that we've seen there and that's the issue that we've been highlighting in the presentations.

In relation to scope clauses, yes, there are some but we still have flexibility. There are absolutely no scope agreements in place with IAG, so there is no limitation on IAG, we don't have labor agreements with anybody, all the labor agreements are with the operating companies but Iberia does retain some additional flexibility within the agreements that they have with their pilots.

Penny Butcher - *Morgan Stanley - Analyst*

Could you just clarify what potential increase there could be, though? So if it was the five aircraft in the summer how much more could it be?

Willie Walsh - *IAG Group - Chief Executive*

I think the issue is, as I said earlier, we don't see that as being the permanent solution. We will continue to see that as one of the opportunities and options that are available to us in addition to using Air Nostrum, which has been a very effective franchise partner for Iberia over a long number of years. So we'll be looking at all options and opportunities to address the issues there.

Penny Butcher - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Thank you. The next question comes from David Fintzen. Please go ahead.

David Fintzen - *Barclays Capital - Analyst*

Thanks. It's Dave from Barclays Capital, just two questions from me, just first on your release of the key aims, one of which is grow Europe to Africa routes. I'm just curious on the level of ambition there, is that something that happens out of the current network or is this an Alliance solution or is it something even bolder than that?

And then just second another quick modeling question, the unit costs ex-fuel down 5.8, for the second half should we be looking at more like the 4% decline in the first quarter or not even quite that?

Willie Walsh - *IAG Group - Chief Executive*

In relation to Africa, I'll deal with that and I'll let Enrique talk to you about unit costs issue. Africa we see as an organic growth opportunity for us, both airlines have got good networks into Africa, we've been able to increase capacity in some of our existing markets there and we see opportunities to expand the network.

Our ambition in Africa is really medium-term because we believe that the economic environment in Africa will improve and will support expansion, in fact the capacity and the demand -- sorry, the demand environment in Africa has been quite positive in recent times. So I see that more as an organic opportunity for both British Airways and Iberia rather than an Alliance issue. And, as you know, we through the Comair franchise agreement would be a very strong brand presence in South Africa and that has worked very well for us historically and we believe it can continuously exploit it.

On the unit cost issue I think we're very pleased with the -- the non-fuel unit cost performance has been very encouraging and we're pleased with our progress there. In relation to the second half Enrique I think has got some --

THOMSON REUTERS

Enrique Dupuy - *IAG Group - CFO*

Yes, as I mentioned, the second half is going to be more challenging. The comparables are going to be tougher. Q3 was a strong I would say quarter last year. So I guess that we're going to have it much more difficult to achieve this level of unit non-fuel cost reductions that we achieved in the second half. Remember it was about minus 5.8% or around. So we see it more on I would say more single digit -- low single digit reductions to be achieved through these next quarters, maybe in the range of zero, minus 1%, minus 2%, that range of figures.

David Fintzen - *Barclays Capital - Analyst*

All right. That's helpful, thanks. Thanks for the color on North Africa too --- or on Africa.

Operator

Thank you. The next question comes from Mr. Jonathan Wober. Please go ahead.

Jonathan Wober - *Societe Generale - Analyst*

Thanks. It's Jonathan Wober at Soc Gen. Three questions please. First of all, just coming back to the search for a structural position as you call it on the Iberia short-haul network, this issue has been live for quite a long time. I think originally Iberia guided us to expect some sort of announcements earlier this year and in the meantime the position I guess in terms of market share isn't improving. I wonder when we can expect a definitive long-term solution to be announced on this? Do you have a deadline in your minds? That's the first question.

The second question, just in terms of clarification on your full-year outlook where you expect significant growth in the operating profit, I just wondered if I could check, last year you reported an operating profit of EUR225m on your pro forma but if we take away the non-recurring items that you put in the pro forma figures it's a higher figure of EUR340m something. On which basis are you expecting a growth in operating profit please?

And related to that, I think consensus is currently somewhere around EUR650m. Is that a figure that you're comfortable with? Thank you.

Willie Walsh - *IAG Group - Chief Executive*

On Iberia, I don't have a deadline. I think with structural issues you -- it's quite different to a tactical problem or a cyclical problem. So for me a structural issue needs the right response rather than an early response and that's what we're considering at the moment, just what is the right long-term response to the issues, the problems that we see there. We've got a number of options that we're looking at and we'll move when we're happy to move.

The focus of Iberia clearly turned to completing the merger rather than dealing with the short-haul issue which was absolutely the right thing to do. And now as part of IAG we're looking at what additional opportunities can we look at from an IAG point of view rather than a standalone Iberia point of view. That's why we're just going over some of the work that Iberia had previously done and looking at some new potential solutions.

In relation to guidance, I'm just going to stick to the guidance that we give and I'm not going to amend it or add to it so our guidance is what we've put out to you today. And I'll be honest with you, I'll wait to see the consensus issues after these results and Andrew and the team will be talking to people in the weeks ahead. But clearly we would expect to be able to give you a lot more detail at our investor presentation on November 11.

Jonathan Wober - *Societe Generale - Analyst*

Okay, thanks.

Operator

Thank you. The next question comes from Juan Ros. Please go ahead, your line is open.

Juan Ros - *BBVA Research - Analyst*

Hello. I have just one question. It's regarding the recent decision of the High Court in Spain, the Audiencia Nacional, regarding the conflict between the Iberia pilots and the Company. Are you expecting any news flow in the coming weeks or maybe back after the summer in September? Do you think that the High Court decision is final or is there any way so that the Company can get a different outcome on this conflict? Thank you.

Rafael Sanchez-Lozano - *Iberia - CEO*

Let me try to respond -- this is Rafael Sanchez Lozano-- and this is quite technical. The issue was there that SEPLA gave instruction to its members about an interpretation of some of the working rules that does not coincide with Iberia management interpretation and clearly that led to some disciplinary actions against some pilots and eventually we decided to bring to the court this issue which was as part of a collective dispute between the parties. What the court has said, it's not a collective dispute, you have to refer to the individual cases because you've only taken disciplinary action against a few pilots. If we would have done it against 100 pilots they might have taken action against but because it was just a few of them they decided at the court that it would have to be dealt with individually and different cases.

Those cases would be reviewed by the court because they'd been referred by SEPLA or their own affected employees and that would go on between September and January next year and there would be individual cases that would be treated individually. There's nothing else on that front or shouldn't be interpreted in a different way.

Juan Ros - *BBVA Research - Analyst*

Just one follow-up question. So do you expect any industrial action maybe this fall regarding the collective bargaining or with this disciplinary issue with the pilots? Thank you.

Rafael Sanchez-Lozano - *Iberia - CEO*

Clearly we don't welcome any disciplinary action and clearly we don't think it's justified based on our willingness to try to reach sensible agreements on that. But I don't know. That affects two parties, not just ours, and I cannot predict what the outcome of all this is going to be honestly.

Willie Walsh - *IAG Group - Chief Executive*

I think -- Juan, thank you for your questions. I think everybody in Spain must recognize that the current challenges in the Spanish domestic market and the Spanish economy and particularly with Spanish very high levels of unemployment, I don't think anybody would welcome industrial action and particularly industrial action by a group of employees who are very highly paid. So I'm sure it's in everybody's interest that these issues be resolved.

But the reality of it is, as a number of people on the call have indicated, we've got very significant structural issues that must be tackled. Tackling those issues are in the best interests of everybody in Iberia and I would argue in the best interests of the Spanish economy because anything that we can do to make Iberia more competitive will help to make Spain more competitive and this should help in the -- in helping to recover the economic environment in Spain.

So we're very clear that these issues must be addressed and these issues will be addressed and we will hope to avoid any industrial action and industrial conflict. Thank you.

Juan Ros - *BBVA Research - Analyst*

Thank you.

Operator

The next question comes from Robin Byde. Please go ahead, your line is open.

Robin Byde - *HSBC - Analyst*

Oh yes, good morning, everybody. Just a couple of finance follow-ups please. Firstly on taxation, you received a UK tax credit in the first half. Should we also expect a similar credit in the second half? And generally, what is the underlying effective tax rate for the Group?

And then just secondly on FX, just to help us with our forecasting of the costs. What sterling/euro conversion rate are you assuming in the second half? Or if you can't give us that the average for the year? Thank you.

Enrique Dupuy - *IAG Group - CFO*

Okay, the taxation positive impact was in the first half related to these new levels being applied on the UK environment. So it has meant a revaluation of the tax liabilities of the British Airways [part of it] and the correspondent gain on the profit and loss account for this first half on a one type of shot type of impact. So we don't expect additional ones coming in the future unless the tax rate changes again.

So the underlying tax rate for the Group probably is in the range of 25% but that's something that we'll have to test through time.

Robin Byde - *HSBC - Analyst*

Yes, sure.

Enrique Dupuy - *IAG Group - CFO*

In terms of the sterling/euro rate, the sterling/dollar rate we're using is in the range of 1.6. So $1.6 for each sterling. And that's probably an adequate assumption for the rest of the year as well.

Robin Byde - *HSBC - Analyst*

Okay, thank you.

Operator

Thank you. And the last question comes from Mr. Edward Standford. Please go ahead.

Edward Standford - *Oriel Securities - Analyst*

Thank you, yes. Just a follow-up. In terms of could you just give a quick update of where we are with TAP and any other conversations you may be having if at all with potential merger partners? Thank you.

Willie Walsh - *IAG Group - Chief Executive*

Thanks, Edward. Well we're not having conversations with anybody at the moment, that includes TAP. However, we are clearly looking with interest to see what the Portuguese government decides to do in relation to the privatization of TAP. So I think you should expect us to look at it, you should not read into that that you should expect us to take any action. But I think the issue is for the Portuguese government to decide. We understand that they intend to pursue the full privatization of TAP but at this point the timelines appear to be slipping a bit and I don't know whether the public statements by a number of carriers, who I think were expected to express interest where it looks like everybody has said they're not interested, will exert some influence on the decision of the Portuguese government.

But if they do decide to proceed we'll certainly have a look at TAP to understand how we could add value or how TAP could add value to the IAG Group.

Edward Standford - *Oriel Securities - Analyst*

Thank you.

Willie Walsh - *IAG Group - Chief Executive*

Okay. That is all of the questions finished now so can I just thank everybody and we look forward to seeing you at our Investor Day which will be held on November 11, Friday November 11 in Madrid. Andrew Barker and the team will be in touch with everybody to finalize arrangements for that but if you can put November 11 in your diary (technical difficulty) we look forward to talking to you then. Thank you very much.

Operator

Thank you for participating in today's conference call. At this time you may disconnect the lines. Thank you.