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IAG.L - INTERNATIONAL AIRLINES GROUP & DEUTSCHE LUFTHANSA AG BINDING AGREEMENT FOR BRITISH MIDLAND LIMITED CONFERENCE CALL

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PRESENTATION

Operator

Good morning, good afternoon and 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).

Now I will turn the meeting over to Enrique Dupuy, please go ahead, your line is open, thank you.

Enrique Dupuy - International Consolidated Airlines Group - CFO

Good morning ladies and gentlemen. As you have seen, we have just announced that IAG has reached a binding agreement to acquire bmi from Lufthansa.

You know, of course, bmi comprises the mainline airline, bmi mainline; Regional; and also bmibaby. Lufthansa is retaining an option to sell bmi Regional and bmibaby before completion. We're basically interested in bmi mainline, which is holding up to 56 Heathrow weekday slot pairs, with a fleet of 27 aircraft, out of which 23 are leased and 4 are owned.

So the bmi acquisition, bmi mainline acquisition, will bring significant synergies, both in terms of costs and revenues.

The cost synergies will be basically focused on elimination of overheads, scale benefits and more efficient use of slots, as well as a utilization of the platforms that we are implementing at IAG level for the service of our affiliates.

In the case of revenues, of course, we have to consider the optimization of an expanded network, the BEA expanded network, and different and better and enhanced customer offering.

Acquiring bmi will mean a total cash consideration of GBP172.5 million. If bmibaby is not sold by May 2012, then Lufthansa will provide compensation to IAG, in order to cover the costs of an orderly exit.



Also bmi's defined benefit pension scheme, the risk and the funding requirements will be retained by Lufthansa. So they are not going to fall on IAG's side.

The consideration I have been just mentioning will be funded out of the existing cash resources within IAG.

And we expect the transaction to be earnings accretive from year 2014 at the latest; that's on the conservative business case that we have built up.

These plans will underpin the target of -- you know about our 12% return on capital employed by year 2015; and it is expected that it will enhance -- will improve by year 2015 the EUR1.5 billion operating profit target by more than EUR100 million. So this will mean, of course, a positive impact on year 2015, maybe before as well, on our earnings per share target and our return on equity target.

The restructuring costs will be spread over three years; of course, a big tranche will be spent in the first 12 months. And in terms of size, it's significantly lower than bmi's current annual losses.

So the completion of the deal, of course, is subject to regulatory clearances from the EC and other relevant competition authorities.

There's a break fee that has been considered of GBP10 million, will be payable by IAG in the event that Phase 1 EU regulatory approval, is not achieved by the end of March year 2012 and just in the, I would say, circumstance that either party would then want to terminate the SPA.

It is hoped that the transaction and it's our aim that the transaction will be completed during the first quarter of year 2012.

In the event we complete the transaction, of course, the bmi membership of the Star Alliance will have to be terminated and Lufthansa will be bearing the associated exit fee costs.

There is also, as part of the consideration that I mentioned, GBP60 million pre-funding to be paid in four installments to bmi pre-completion. This funding will be secured through London Heathrow slots that are owned by bmi. And, of course, these advances will be deducted from the final purchase price at completion.

So we have identified in this, I would say, conservative first business case that we have applied, significant room for unit cost reductions, post acquisition. It has to do with elimination of duplicate overheads; scale benefits through IAG engineering, through IAG distribution and marketing synergies.

There is a question around the aircraft size and the sector length that will improve and will be bringing lower unit costs. There is also the possibility to finally co-locate bmi mainline capacity at Heathrow in the Western Campus, so I'm talking about T5 and T3, compatible with the rest of IAG, after the T2 Phase 1 completion, will be finished by year 2013. So that's another, I would say, possible source of cost savings that we're envisaging.

On the revenue side, significant room for unit revenue improvement through a greater range of destinations and British Airways and IAG customers, better network connection opportunities for passengers, and a significant improvement, I guess, in our product and service proposition to clients.

On a more, I would say, strategic overview, BA currently has, as you know, approximately 44% of Heathrow slots. This acquisition would be taking IAG's slot share, so this BA, Iberia, bmi, to around 53%.

I was mentioning bmi is using a smaller aircraft per slot than British Airways. So, for example, bmi is using average 120 seats, while British Airways is around 200 seats, which is more or less the average of London Heathrow as a whole.

Bmi has been using Regional 50-seaters on 25% of Lufthansa -- of London Heathrow slot portfolio, which is a significant proportion being dealt with very small aircraft.



It is, of course, these long-term network opportunities for Iberia will have to do with opening new long-haul routes and improving our frequencies. And these will broaden the range of destinations that IAG will be able to serve out of Heathrow. So today it's about 160, 162 destinations, and we can compare with a 229 out of Paris or the 252 out of Frankfurt, in the summer of year 2011, so there's a significant scope for improving, enhancing, broadening our long-haul range of destinations. There will be a more efficient use of slots, better connections, as I mentioned. And, of course, these will bring more opportunities for IAG Alliance partners.

So this is a brief summary of how we are seeing the opportunities and the challenges behind this deal, and I will take now your questions, if you require. Thank you.

QUESTIONS AND ANSWERS

Operator

We will now begin the question and answer session. (Operator Instructions). Tim Marshall, Redburn.

Tim Marshall - Redburn - Analyst

I just have a couple of questions. Firstly, is IAG buying bmi, or is British Airways buying bmi, and how will the airline work? Will it simply be rebranded British Airways with all the staff becoming British Airways staff, or is there a scope for doing it slightly differently?

Enrique Dupuy - International Consolidated Airlines Group - CFO

We are basically now working with different options. We want to maintain certain degrees of freedom, in terms of how we'll be finally operating these slots. So there is a scope for becoming an integration; bmi mainline could be finally integrated into BA network. But also there is an alternative we are considering seriously, about maintaining bmi as a differentiated standalone tool. Of course, you're seeing British Airways brand and codes.

And the final outcome will have to do with the discussions -- the negotiations that we have to maintain with the incumbent parties. Because, of course, integration will only be feasible and reasonable if you are able to obtain the adequate agreements with all the stakeholders. So that's how we are envisaging this next phase. And as I said, we still remain flexible.

Tim Marshall - Redburn - Analyst

And what would be the -- when would that decision need to be finalized? Presumably by the date of the deal being done, or --?

Enrique Dupuy - International Consolidated Airlines Group - CFO

Absolutely, before completion. So we are already opening these discussions so as to be able to have them completed by the end of the first quarter, or before.

Tim Marshall - Redburn - Analyst

My second question was simply about the -- my understanding is that the total slots for bmi is something in the region of 85, somewhere around that. So presumably, there's some bmi Regional slots at Heathrow that you would not envisage taking, is that right?



Enrique Dupuy - *International Consolidated Airlines Group - CFO*

No, not really. We are taking 100% of the slots of bmi, with the exception of the ones we acquired, remember, a couple of months ago. So of course, we'll have to analyze carefully which slots we are going to operate, with which aircraft, and to which destinations and that's an exercise that we are now fine-tuning. But we don't -- we're not considering non-operating a material number of slots out of bmi.

Tim Marshall - *Redburn - Analyst*

Okay, that's lovely. Thank you very much, Enrique.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Thank you Tim.

Operator

Douglas McNeill.

Douglas McNeill - *Charles Stanley Securities - Analyst*

You referred a couple of times, and in the statement, to the current annual losses of bmi, in relation to the restructuring costs. Would it be fair to assume that those losses will be about GBP175 million this year, at the operating level?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

We don't have the final figure. We know that they're going to be probably above the level of the year 2010. The figure that you mentioned could be, I would say, reasonable, but I don't want to commit to specific figures -- specific numbers because I don't have the data. But the range that you have mentioned is perfectly reasonable, yes.

Douglas McNeill - *Charles Stanley Securities - Analyst*

Understood, thank you. And one other, if I may; when you say earnings accretive by 2014, at the latest, would it only be earlier than that if you managed to sell bmibaby?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

bmi baby is not included on our plans in any case. So in the numbers I have mentioned bmibaby will not be part of our business case.

The opportunity of accelerating the break even dates and the return to profitability, is more related to the opportunities that now we are facing in terms of optimizing the business case, that as I just told you, has been constructed in a very conservative-type of assumption, in order to be able to have an appropriate valuation, in order to negotiate the price. So we think that we have still some room for improvement, and we are going to sharpen our pencils, in order to be able how much we can make in order to accelerate and improve future earnings.

Douglas McNeill - *Charles Stanley Securities - Analyst*

Understood. That's very clear, thank you very much.



Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Thank you Douglas.

Operator

Edward Stanford.

Edward Stanford - *Oriel Securities - Analyst*

Just couple of questions, if I may. You've not quantified the amount that Lufthansa might pay in the event that they don't sell bmi baby, but there's this thing in the Lufthansa statement suggesting that it could be clearly negative. Does that imply that they will pay you a net amount of money if bmi is -- you take on bmi baby?

Secondly, could you give some flavor on your current plans of 2014 being earnings accretive, of when actually bmi might break even?

And finally, could give a flavor of your discussions with the Competition Authorities at this stage? Thank you.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Okay. You have to allow me not to be very concrete on the amount of the compensation because, of course, it's very commercially sensitive. You can understand that the final decision, the final exit that we envisage for bmi baby could be in some way interfered if that figure, that amount, would be public. So what I can say is that the amount that we have negotiated as a discount, as a compensation, leaves us comfortable about the final exit being applied, not endangering, not impacting negatively our business case on bmi mainline. So that's the basic message that they would want to transmit at this stage.

In terms of year 2014 break even, well that's, as I have expressed, our business case, our conservative business case assumption, for break even. Of course it's going to be very much influenced by the final date of completion of the transaction; and also by this fine tuning, sharpening of pencils, exercise that we are now producing; and also by the final solution that we will be undertaking for the operational tool being used, or integration, or maintaining bmi mainline as a different entity.

So all these still uncertain aspects are the ones that will play in being enabling us to shorten the period of losses that we are going to suffer. And we are confident that we will be able to do so.

In terms of the Competition Authorities, of course, we have initiated our conversations with them. We are now interchanging documents data papers. I would say that we feel optimistic. We feel we have a strong case because we're still below in terms of share on the slots to the figures, the percentages, that most of our competitors are able to hold on their own home paths. So I'm talking about Frankfurt, or Paris Charles de Gaulle, or Dallas, or even Stansted. So, we think we have a strong case and we are confident we will be able to reach an adequate agreement with the Competition Authorities soon.

Edward Stanford - *Oriel Securities - Analyst*

Thank you.



Operator

Peter Hyde, Liberum Capital.

Peter Hyde - Liberum Capital - Analyst

Can I just ask a couple of questions, firstly in terms of slot pairs. You talked about 56. I'm under the impression that some of them are currently being leased out to bmi Regional. Does that mean that if bmi Regional gets sold by Lufthansa you might not acquire the full 56 slots? And what's your stop gap at the back end of that? Is it 50? Or is it 45? Or what happens to the purchase price if suddenly you find you've only got 50 slots rather than 56 slots?

Second point was, you talk about using some of these slots for more long-haul destinations. Have there been barriers that are outside your control to be able to use these slots for long-haul destinations or can you almost, not quite in one go, when you talk about sharpening your pencil Enrique, can you bring forward the conversion of some of those slots from, let's say, short haul to long haul immediately? Or are there regulatory things which are outside your control?

And then the final point, I just wanted to check, you talked about 2015 of EUR1.5 billion target, should we now be thinking of it in terms of EUR1.6 billion, because of the EUR100 million incremental from bmi? Thanks.

Enrique Dupuy - International Consolidated Airlines Group - CFO

Thank you Peter. In terms of the slots, of course, our preferred asset in this transaction is about the slots. So we are going to need, and we are going to keep the 56 average daily slots -- pair of slots, that bmi is operating. So that's for sure. [And if we] have to agree on not using some of them we will receive from the user the adequate compensation. But we are basically intending to keep the 56 average pair of slots.

Peter Hyde - Liberum Capital - Analyst

Okay, so if you took the 56 slot pairs, you're paying GBP172.5 million. But if, for instance, three slot pairs had to go with bmi Regional, then basically you'd get a bit of compensation to reflect that fact?

Enrique Dupuy - International Consolidated Airlines Group - CFO

Or we keep them. Or we get rid of the slots. Or we keep the slots and we arrange a way Regional can operate in a different way.

Peter Hyde - Liberum Capital - Analyst

Okay, thanks.

Andrew Barker - IAG - Head of IR

Peter, just to clarify, there are some slots in the 56 that are leased out to other carriers and obviously when the leases expire they revert to us. That's important to our break even analysis as well. It's one reason why 2014, at the latest, is the break even point.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Okay, on the question about the local opportunities. Of course, this is probably one of the issues in which we are trying to sharpen our pencils. We have built up this conservative case having to do with our opportunities to open new destinations on the long haul, and increase our frequencies. And, taking into account what's basically happening in the marketplace, we have preferred to be conservative in this case.

But we will review, we will revisit this issue. We will analyze in each case the opportunities that we may be having to make this slot transformation into long haul, the sooner the better, as soon as possible. And that's basically an exercise that we are now going to be dedicated to.

In the third question, yes I think that your assessment is totally right. And we should be considering now that if we are able to complete the deal, our target, for year 2015, should now be reconsidered and increased to EUR1.6 billion.

Peter Hyde - *Liberum Capital - Analyst*

Okay, thanks.

Operator

Geoff van Klaveren, Deutsche Bank.

Geoff van Klaveren - *Deutsche Bank - Analyst*

My first question is really how much of the restructuring is about changing routes on the slots? And is it too late now with the summer schedule of summer '12 to make some changes there? And then, secondly, just in terms of the aircraft, you mentioned they use 120 seaters and you could get a unit cost advantage by gauging up. What flexibility do you have to send their aircraft back to the lessors?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

In terms of the restructuring of routes and slots, on the very short term, that's one of the reasons why we're aiming to complete the transaction before the end of the first quarter; because we would like to take the opportunity to get the slot allocation for the next season on our side, on our decision capacity. That's why we're rushing. We're running and there we have these aims.

So if we're able to complete by the end of the first quarter we will have this opportunity of using very soon our slots in our broader combination of slots in Heathrow. And this would enhance the opportunities to reduce the interim period, the loss-making interim period, as much as possible.

In terms of the aircraft, of course, as IAG we have opportunities, options, on our Airbus A320 family fleet. And we'll be using them to create opportunities to enlarge the average size. So we have options on the A320s that we may be using. And we have a very close contact with Airbus that will be fruitful if we decide to go that way.

Of course it would be easier on the leased aircraft because we have windows that we can use to get rid of those leased aircraft. On the case of the owned aircraft we will have to make a specific case to see what is the benefit of early retiring these older A319s, and substitute them through A320s. But I'm sure there's going to be a quite clear business case for that purpose.

Geoff van Klaveren - *Deutsche Bank - Analyst*

So Enrique, just to clarify then, so it's winter '12, is it winter '12/'13 is the first period you're targeting?



Enrique Dupuy - *International Consolidated Airlines Group - CFO*

That's correct. We will get, remember, to March.

Geoff van Klaveren - *Deutsche Bank - Analyst*

Okay great.

Operator

Neil Glynn, Credit Suisse Securities.

Neil Glynn - *Credit Suisse Securities (Europe) Limited - Analyst*

My first question, you mentioned the EUR100 million uplift to 2015 earnings' potential. I'm just trying to understand as to what part a turnaround of bmi mainline may contribute to that before considering synergies. As part of the due diligence process, have you a feeling as to what kind of a reasonable margin might be targetable for bmi mainline?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Okay, bmi mainline has, in front of us, two basic exercises. First one is having to do with cost restructuring and of course it will be affecting employees. It will be affecting the basic supplier costs of bmi mainline. And that's an exercise in which we are going to focus since completion and probably very intensively in the first months of operation. That's a period that we are going to be using to increase our connections on our short and medium-haul network.

After that initial period, we think we'll be able to break even on bmi mainline and we will begin at the second phase which is about slot migration into the long haul. And for that purpose, we will be having to get the appropriate long-haul aircraft. We have some opportunities because, as you know, we will be receiving 787s and 380s through year 2013 and then we will have to maintain our 747 fleet a bit longer than initially expected. So instead of substitution, we will proceed on a phase of growth in our fleet on the long haul since year 2013.

So we will be achieving the cruise speed by year 2014/'15 and that's basically the exercise that now, in these next months, we will try to optimize.

So in terms of margins, the basic aim is to have an average margin in bmi which is at least as good as the one we are operating through British Airways in Heathrow on the same type of slots, the same type of routes.

Neil Glynn - *Credit Suisse Securities (Europe) Limited - Analyst*

Understood. Very clear. Can I follow on from that by asking about -- Willie had mentioned in the statement earlier about the prospect of new additions to the network over the medium term as you've just touched on there. I'm interested in your thoughts on how the competitive landscape eastwards is developing.

How do you manage the prospect of continued ramp up in capacity from both Asian and Gulf carriers as well considering your own opportunities? And also maybe if possible, if you could give a nod to what Air Berlin has obviously done at the start of this week and its ramifications from one of One World's leading members.



Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Yes, well these are very broad questions, I'll be very brief about them you can imagine, because we could spend here a couple of hours on these subjects.

As we have expressed in several locations, because of our position in Heathrow and because we have been competing for quite a long time now with the Middle Eastern-type of companies, we really are comfortable in this basic, I would say, battlefield. We're not so much worried. We're making big money on our routes to the Middle Eastern countries and we have a strong position on direct traffic out of Heathrow and into China and Far East destinations which are not basically being endangered by the Middle East carriers.

So these -- really this acquisition will allow British Airways, which is extremely important, the opportunity for growth in our home hub and this is an aspiration that any hub airline would have as really very, very strategic. For us, it was very difficult in the past because of Heathrow slot constraint and restrictions; we were envisaging a few opportunities of being able to execute a growth in our network and now we have this opportunity in front of us so we think we really are going to benefit out of it.

Neil Glynn - *Credit Suisse Securities (Europe) Limited - Analyst*

Great. Thank you, Enrique.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Thank you Neil.

Operator

Gerald Khoo, Espirito Santo.

Gerald Khoo - *Espirito Santo - Analyst*

I was just wondering if I could ask you to clarify one of the earlier comments regarding the Lufthansa compensation in the event that they can't sell bmibaby. Is that a fixed amount, and therefore leaving you at risk if there's an overrun? Or are they completely on the hook for all of the shut down costs?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

If they decide not to exercise the option they have to sell bmibaby, then it will become a fixed amount, yes.

Gerald Khoo - *Espirito Santo - Analyst*

Okay, thanks.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Sorry I cannot disclose the amount, but I can tell you we have made our numbers and we're comfortable, or very comfortable even, that the amount that we have negotiated will allow us to go through an exit process without affecting the -- negatively the figures, the business case, that we have assumed for bmi mainline company.



Gerald Khoo - *Espirito Santo - Analyst*

Okay. And you're confident that you don't need a similar arrangement for bmi Regional?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Well the case of bmi Regional is different. The size of the losses of bmi Regional are modest or very modest; they are very near break even. And the opportunities that we have been envisaging and Lufthansa is envisaging about selling bmi Regional, are much more clear or even close opportunities. So bmi Regional is a different scale of a problem.

Gerald Khoo - *Espirito Santo - Analyst*

Okay, thanks very much.

Operator

Alexia Dogani.

Alexia Dogani - *Liberum Capital - Analyst*

I just had a very quick question actually. On the long-haul routes that are governed by bilateral agreements and traffic rights, is BA currently operating at the maximum fully allocated frequency level?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

No of course not, and this is the reason why we are confident in being able to use the slots sooner than later on our long-haul destinations, and improving our long-haul frequency-type of profile. So we are not exhausting the opportunities that we have through our bilaterals and we think that we may be expanding our bilaterals if we require so, but we are comfortable that through the next two/three years we could be able to exhaust these long-haul growth opportunities if the demand in the market grows and performs in an adequate way.

Alexia Dogani - *Liberum Capital - Analyst*

And could you give us a rough utilization level, let's say argue 50% operating of the allocated levels, or 80%?

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

It's a case-by-case type of exercise so we will be talking maybe about 10/15 countries; each of them has its own bilateral agreement, so it's very difficult to talk about an average. But what I can confirm you, what we can say is that that's not the problem that we are facing now.

The problem that we are facing it's more about having the adequate aircraft and having the adequate demand profile in these markets. So if we get the aircraft and the markets recover and we get the adequate demand profile, we will have no problem in using the slots where we want to use them.



Alexia Dogani - *Liberum Capital - Analyst*

Okay, great. Thank you very much.

Operator

Thank you, sir. There are no further questions.

Enrique Dupuy - *International Consolidated Airlines Group - CFO*

Okay, thank you, everybody, then. Bye-bye.

Operator

Thank you for participating in today's conference call. You may now disconnect. Thank you.

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