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IAG.L - Q1 2014 International Consolidated Airlines Group SA Earnings Conference Call

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CORPORATE PARTICIPANTS

Willie Walsh *International Consolidated Airlines Group SA - CEO*

Enrique Dupuy *International Consolidated Airlines Group SA - Group CFO*

Keith Williams *International Consolidated Airlines Group SA - Chairman, BA*

CONFERENCE CALL PARTICIPANTS

Mark Manduca *Merrill Lynch - Analyst*

Jarrod Castle *UBS - Analyst*

Neil Glynn *Credit Suisse - Analyst*

Wenchang Ma *JPMorgan - Analyst*

Oliver Sleath *Barclays - Analyst*

Robin Byde *Cantor Fitzgerald - Analyst*

Andrew Lobbenberg *HSBC - Analyst*

Suzanne Todd *Morgan Stanley - Analyst*

PRESENTATION

Operator

Good day and welcome to the International Airlines Q1 2014 earnings presentation conference call. At this time I would like to turn the call over to Mr. Willie Walsh, CEO. Please go ahead, sir.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Thank you and good morning, everybody. I'll hand over to Enrique Dupuy, who will take you through the presentation on the first-quarter results. And then I'll come back to you when Enrique has finished to deal with your questions.

Thank you. Enrique?

Enrique Dupuy - *International Consolidated Airlines Group SA - Group CFO*

Thank you, Willie. Good morning, ladies and gentlemen. We're going to be going through what we judge as a successful set of first-quarter results for IAG Group and for its three operating companies.

If you focus first of all on our operating results for the quarter, we have been able to improve on a reported line the results for the first quarter by EUR128m. Of course, this includes Vueling this year and it didn't include Vueling on year 2013 results. So making a like-for-like exercise, the increase would be a EUR158m improvement.

In terms of the underlying reasons beneath, I would say, this improvement in results, we will be mentioning the performance of our unit passenger revenues, which it is at the reported level of minus 2%, but it is affected by Vueling not being in the base of last year and a certain weakness in some of the currencies we use, especially the dollar. So on a like-for-like Iberia plus British Airways comparison exercise, the passenger revenue has been dropping just 0.5%.

If we take into account the Easter holidays in this year, in April, against last year in March and also the increase in stage length that we have introduced in our network, we are on a very flat -- flattish, I would say, unit revenue pattern, as we thought we were going to be.

In terms of the cost performance, it's important to focus on the non-fuel unit cost performance on a reported basis because of the same reasons, the same two reasons, so dollar weakness basically and Vueling not in the base, we would be getting to a reduction of minus 7.2% on reported terms. Correcting to like-for-like comparison we would be getting to a minus 4.2% reduction, which I do think it's a very substantial improvement and that is has been happening through our three operating companies. So British Airways, Iberia and Vueling, as you will see later on.

If you take into account a slight improvement in the fuel costs and also the significant impact of weaker dollar in the fuel bill, the total unit costs on like-for-like basis would be getting to minus 4.7%. So these two KPIs, passenger unit revenues, total unit cost, are the ones underlying the significant improvement on our operating result for this year.

If we go to the next page and we get to a more detailed chart on where we show the different aspects of the improvement. First of all, we get to a corrected EUR145m like-for-like first-quarter improvement, and that's just adjusting Vueling, as I told you, and a small ForEx positive net impact on our operating result we had this year of EUR13m.

Let's go through the EUR145m figure. Of course, it has to do with capacity growth and then passenger revenue growth. We see the significant impact coming from volumes, slight -- very slight deterioration coming from price and mix effect. We also recognize the non-passenger revenue performance, a negative impact still on the cargo business. So cargo probably for the first quarter of the year and later on will be stabilizing in terms of volume figures. There are still some weakness on the year performance. And this quarter they've been responsible for most of the EUR11m non-passenger negative impact.

And then coming to the cost side, we see of course the negative impact coming from volume. So more capacity, more cost base. But we also recognized some significant improvements in fuel in terms of price effect, nearly EUR80m. And very important on ex-fuel costs, specifically on areas as employee cost and supplier cost. So we will go on more detail on these improvements, but it's important to recognize the very significant effort that the Group is doing on these non-fuel reduction -- cost reduction exercises, especially the very significant positive impact on labor cost that will be explained later on.

On the ownership cost, there is a slight negative, of course having to do with additional capacity and also slightly on, I would say, a more pronounced depreciation pattern for the 747 fleet due to lower expected residual values.

Turning to the following page, here is where we are getting a bit more a flavor on the ex-fuel unit cost performance. So on the chart we see that we are reporting a minus 7.2%. Of course Vueling, with its lower cost base, is responsible of minus 2 percentage points on this figure. And weak dollar is responsible of minus 1. So on a like-for-like comparison exercise, the figure that we should be focusing in is this minus 4.2%.

And then if we go to the different categories, we see British Airways having a significant, I would say, improvement. And this is basically because of the, I would say, the efficient cost -- growth exercise that we are producing through the introduction of this new-generation fleet that provides additional gauge and additional stage length, and of course a benefit in most -- on the non-fuel cost lines.

For Iberia it's even more important, as you will see in further pages. And of course it has to do with a combination of year 2013 first quarter pre-mediator agreement, pre-restructuring, and first quarter of year 2014 with a significant progress on our mediator agreement implementation. So significant improvement in the employee cost base for Iberia.

On the supplier cost side, what we're seeing is improvement in terms of stage length positive impact, both handling, catering and landing fees. So these stage length additional increase means that those costs that have to do mainly with departures, also with landings and handling people at the airports will be diluted through additional kilometers. This is part of this positive effect.

We're having some inflation behind landing fees. And this is basically related to Heathrow additional charges being still prevailing in respect of high increases again last year, until the month of April, and some Eurocontrol inflation as well.

Engineering is benefiting from the rolling over, the same period of last year, when remember we were talking about preparing the companies for new fleet. So this has been on a year-to-year comparison a significant improvement for this year's accounts.

Selling we see a negative. And this negative we would like to turn it into a positive because it's basically related to Iberia efforts in improving the brand and then investing and the website new launching. So this is something that we will be seeing in these quarters but it will be returning to normality in the following ones.

On the ownership side, we see a double combination of, as I told you just previously about, additional depreciation, especially on the 747 fleet, and some relief on the operating lease cost area. And this is because last year we still had a significant ex-BMI operating leases that now have been all integrated on our balance sheet or just abandoned out of the IAG Group.

So getting to then the fuel costs, and this is always, I would say, a tricky exercise to do because when we talk about reference price, for example, in the chart we're including a $980 per metric tonnes of kerosene reference price, but we know it has been close to $1,000 and close to $960 just in the last, I would say, three weeks. So this is just an example on the $980 level. And it shows how if we -- if it happened, how it would be comparing against last year, the same quarters, on an after-hedge type of final cost.

So slight tailwind on Q2 and Q3 and slight -- sorry, a slight headwind on the Q2 and Q3, and then again a slight tailwind on Q4 and Q1 year 2015. So very much aligned with last year's figures. And this of course is before two aspects that would impact positively. On one side, it's the new generation on the twin-engine fleet in Iberia, and this improving, I would say, unit consumption in terms of tonne per ASK. And the other one is a weaker dollar than we had last year.

So we don't expect, I would say, significant variations on the fuel bill, and maybe as a whole, on a net basis, a little bit of a tailwind again as we had on the first quarter.

Let's go then through capacity growth and how the three companies are going to be evolving through the following quarters. For this quarter what we see is that on a like-for-like basis, so Iberia and British Airways, and carving out what has been the Vueling growth which was not there last year, we see a combined growth of 3.7% and then it's British Airways 5.9% and Iberia minus 3.3%. Vueling, which is out of this figure, has been growing 24.5%.

Then how we see the following quarters? Q2, British Airways will be growing at about 7.3%. Iberia would abandon the negative territory into a growth of around 3.3%. Vueling will be keeping a high level of growth at a range of 27%. Our like-for-like Iberia plus British Airways, it would be 6.4%.

So for full-year 2014, what we're seeing is a like-for-like 6.1%, a reported figure of 8.1%, including Vueling. And then, as a whole, we're seeing British Airways at around 6.4%, Iberia at around 4.6%. And these figures will be monitored very closely and maybe adjusted through the following quarters in some way, basically probably a little bit on the downside.

So getting to the pattern of how we are producing this growth in the following page, page number nine, now this is a chart that resembles to the one we showed last quarter. We try to bring a little bit of clarity on what we are calling this efficient growth concept. So if we talk about Q2 for British Airways, the combined growth of 7.3% we were talking about will be composed by new routes, new routes accounting for 1.6 percentage points. And this is basically, as you know, Chengdu and Austin. There's going to be a little bit of discontinued routes. In the case of British Airways it's going to be discontinuing Lusaka.

And then we get to what we call the like-for-like changes. And this is basically about aircraft additional gauge. So this is the A380s. And this is responsible for 1.2 percentage points.

There's additional frequency increase in some routes, for example, in the case of British Airways, New York, Seattle and some long-haul Gatwick-based routes. But then it's very interesting to understand that the sector stage length increase is 2.3 percentage points. This is about one-third of the total growth.

When we get to the negative impact on the unit revenue base, this is, as you know, mathematical negative impact, which has its correspondence on the cost side. It's basically responsible for most of the negatives that we are seeing on unit revenues in this first quarter.

If we get to Iberia, new routes will be accounting for 0.8 percentage points. And this is basically having to do with Berlin and Stockholm and maybe other short-haul routes that will be recovering a broader network feed-in through Madrid. There's some discontinuation, a small discontinuation of some short-haul routes as well. And then on -- again on what we call the like-for-like changes, there is again an increase in stage length of 1 percentage point, again responsible of about one-third of the total ASK increase, which is very significant.

In the case of Iberia, the aircraft gauge is coming down. And this is because of the 330/A340 mix, which is bringing us to, I would say, smaller aircraft. And that's something that probably will follow in the future. And there is a bit also of additional frequencies also on North Atlantic destinations.

So this is how it shows. And now we are going to be getting to how we see the world network universe performance for the Group through this last quarter. In this chart, which is again similar to the one we presented last quarter, we're showing, on the left-hand side, capacity development, and on the right-hand side unit revenue development on the same sectors. So let's begin by talking on the Americas.

North America has been benefiting from a strong 8.8% growth. And this has to do with both A380 introduction, some new frequencies and some new routes, as the case of Austin. As a whole it has been increasing stage length as well. In terms of unit revenues, it has been a minus 1.4%, which we judge -- we consider that represents a reasonable and balanced response to the capacity increase on the demand side. So we don't see any unbalance or disequilibrium on that specific sector, not in the first quarter, not what we're seeing in the following quarters' bookings.

What about Latin America? Latin America has been cutting capacity. And this is basically the tail of the Iberia restructuring on a first-quarter comparison base. It has been a type of a mixed performing area, with a couple of countries, maybe three performing weaker. Basically we're talking about Brazil, Argentina and Venezuela. And some others holding quite strongly. So countries as Mexico or Peru, Colombia, or Chile. So it's a mixed type of performance, with some specific weakness concentrated mainly basically in Brazil. The unit revenue performance has not been bright, but it's holding at close to breakeven basis, minus 0.8%.

Then to domestic. The domestic shows a little bit of the finishing of the restructuring exercise that both British Airways and Iberia have been doing. In the case of Iberia, has been restructuring having to do with the whole mediator exercise and also balancing capacity with the internal demand. In the case of British Airways has been the end of the BMI ex routes restructuring exercise. So this is positive because after this capacity adjustment we are seeing unit revenues slightly recovering again on the positive side, 1.8% up.

For Europe, for Europe it has been a growth of around 3% and a certain weakness in terms of unit revenues, minus 2%. Maybe this weakness is not as significant as there was at some of our peers have been showing recently. And basically it has to do still with, on one side, weaker Spain-Europe routes and also a little bit of the effect of Iberia strikes in the base, which drove load factors last year quite high because of restructuring the schedules.

In the case of Asia Pacific, probably is a little bit of our star performer in this quarter because we are seeing capacity increases of around 3% and unit revenue improvement of around 7.4%. And this is basically concentrated around our Sydney route, so you know Heathrow-Singapore-Sydney route. It's also improvements on our London to Shanghai route. So this is in a row, I think it's about the third quarter where we are seeing a specific unit revenue improvement in terms of performance.

And then finally Africa/Middle East. This is about growth that has been concentrated around Joburg and India. In India we'll be moving soon maybe to 787, so this growth will probably be fine tuned. And a bit of weakness especially in India, especially in India where the market is probably a bit over-served.

So as a whole we can say it's what we call at the planned level of capacity we wanted to introduce on this efficient growth exercise, and also the planned response in demand and unit revenues, with a bit of an impact on RASK having to do with stage length increases.

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If we follow to the next page, so it's page number 12, we get to a little bit of an additional color on revenues on Q1 full revenues on a like-for-like basis again. This is coming down to minus 1.2%. And you'll recognize soon that the negative trend between 0.5% and 1.2% is basically due to cargo weakness.

In terms of passengers, what we are seeing is on the long-haul premium improving, and non-premium being slightly lower. But this is again having to do a lot with Easter because, as you know, March last year was basically benefiting from Easter holidays, which, as you know, are basically non-premium-biased and against the premium traffic.

So on the short haul we see a little bit of the same. So Iberia -- British Airways remaining more or less the same. Iberia suffering a little bit because of a lack of Easter March passengers. And finally the cargo impact, negative impact that we have been mentioning several times.

So then getting to the next page, this is 13, where we're showing the relative performance of the three companies, so British Airways, Iberia and Vueling. And then again we have to emphasize the improvement that we're having across the board. So for British Airways, operating result is getting to breakeven level. If we compare this breakeven level with other legacy carriers in Europe, I think it's a very significant achievement. It doesn't mean we are happy with first-quarter British Airways on a breakeven and we are aiming for more improvements through the next years, of course.

It's important to take into account the base behind this improvement, that it has much to do with cost improvement, unit cost improvement. And it's worth to signal the improvement in productivity and employee cost per ASK, minus 4.5%, which is driving most of the CASK ex-fuel, minus 4.8%, and then the total cost per ASK -- unit cost per ASK of minus 6%.

In the case of Iberia, it's about nearly halving the losses. So it's EUR91m improvement to a loss of EUR111m. And then again worth to mention the improvement in unit employee cost per ASK. If we look at Iberia, nearly 18%, so very significant. We also see an accelerated pattern in terms of revenue per ASK. And this, in some way, shows how the mediated agreement is being implemented through 2013 and 2014 and the huge impact that it's having on Iberia performance.

For Vueling, basically the challenge was and is to hold profitability in terms of margins through these very significant growth pattern that for this quarter has been 25%, around 25%, and that will be remaining at very similar high levels through the rest of the year. So for them it has been, I would say, very challenging but also very successful, to keep the level of losses where they were last year, with a modest decline, and again to be able to achieve this significant improvement in unit cost per ASK, and especially again on the employee side. So what I would be calling as positive news on the three operating companies.

Getting to our financial structure, not very much to say. Not a lot of news. But maybe just positive ones because what we are showing is a cash improvement for the Group of around EUR300m in a quarter which is, as you well know, especially weak in cash generation, as it is the first quarter. So this has been enabling our balance sheet net debt to be reduced as well, and the adjusted net debt, including aircraft operating leases, to be also reduced. So adjusted gearing will be remaining at around 50% through this first quarter, as has been the range of our guidelines for the last couple of years.

If we get to the market environment, page 17, we're happy to say this chart is again a boring one. So nothing very relevant to show. This is basically good because we feel that there is still significant balance between capacity and demand on our main strategic markets and is happening both on the non-premium and on the premium segment of the traffic.

Again, on the cargo, we see weakness as a whole. As you know, we are retiring and getting rid gradually, through this part of the year, of our freighters. This is going to be meaning less revenues and less costs, with a positive, I would say, net contribution.

And then finally what we would be telling you in terms of our guidance is about an operating profit improvement for the Group for the full year that we would account, we would value at least in the range of EUR500m at actual levels of fuel cost and foreign exchange. So getting to EUR1,270m at least operating results for the full year.

And this will be again based on a unit revenue flattish pattern for the full year. And basically then on this efficient growth behavior, that will have a positive impact in ex-fuel unit cost, which will be coming down. And the fuel bill, it's an area in this specific case we are just valuing in the range of EUR6b for the full IAG Group full year. But the cost will be dependent on these very volatile variables as ForEx and market prices.

The capacity growth that we will be reporting will be in the range of 10.3% on a pro-forma exercise. So basically carving out the differences happening between before the incorporation of Vueling to the Group, it will be about 8.1%.

As a summary, I would label Q1 then as a steady progress on our way to the year 2015 targets.

Thank you. And I then pass the word again to Willie.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Thank you, Enrique. So, as you've seen, I think overall a good performance during the first quarter, with progress being made in all three of the operating companies.

So over to you for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Manduca, Merrill Lynch.

Mark Manduca - *Merrill Lynch - Analyst*

Hi there. Very, very quick and easy question from me. Can we just talk a bit about the depreciation change? And specifically how I should think about it as a one-off? What element of it is one-off in nature? And to what degree will it be repeating throughout the year?

Enrique Dupuy - *International Consolidated Airlines Group SA - Group CFO*

Yes, well, this is basically affecting our expectation on future residual values of the 747 fleet so that will be basically impacting our accounts from now to -- gradually to, I would say the final expected operating life for the 747 fleet.

So this is representing an additional depreciation impact of EUR23m on this first quarter. And the figures will be very much the same through the following quarters.

Mark Manduca - *Merrill Lynch - Analyst*

So I guess the underlying numbers would therefore argue to be slightly better?

Enrique Dupuy - *International Consolidated Airlines Group SA - Group CFO*

Yes.

Mark Manduca - *Merrill Lynch - Analyst*

Thank you very much.

Operator

Jarrod Castle, UBS.

Jarrod Castle - *UBS - Analyst*

Good morning, gents. Three questions if I may. Just on the other revenues, clearly you said there was the impact relating to Vueling in terms of the handling and maintenance revenues which explains the reason why they down. Can you just tell us on an underlying basis what other revenues were doing and just give a bit of color around that?

Secondly, just in terms of Iberia given the track record I guess just some color in terms of -- I guess it will be profitable this year right? If you've got any kind of divisional detail Iberia, British Airways you've clearly given a lot of detail on British Airway's progression from last year to the EUR1.3b 2015.

And then lastly and maybe one for Willie, I asked you at the full year results about Qantas if you'd be interested to help them out. Your answer was no. Possibly I guess you're looking at Europe a partner such as Finnair, would you be interested in -- of taking a minority stake there should it come up? Thanks.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Okay, well, let me deal with the last question first. The answer to that is no as well. Finnair is a good partner within the Oneworld alliance and the transatlantic joint business, but we don't see any strategic value in a minority stake in Finnair so that's our situation at the moment.

We do enjoy working with them and we will look to see if we can expand our cooperation if there are any areas of potential expansion. But we think working together we can generate additional value and that we can do that without equity participation in the company.

I'll hand over to Enrique in relation to the other revenues.

Enrique Dupuy - *International Consolidated Airlines Group SA - Group CFO*

Yes, when we are talking about other revenues for the Group in terms of the impact in this quarter the significant issue has to do with cargo revenues. So cargo revenues are coming down because of a reduced freight air operation and also because of yield reduction.

There is a technical accounting issue around the consolidation of Vueling that we didn't have in our accounts last year and this first quarter and we have it now. So it eliminates cross-revenues and costs in the handling area and also in the maintenance area, so it's bringing down both revenues and costs from an accounting point of view.

Apart from that we have third party revenues. That's the real side of this revenue line. And this is behaving basically quite regularly and with similar levels as the ones we had in last year. There is also other sources of additional revenue British Airways holidays is one of them and we can still, I would say, emphasizing the respect that the BA holiday business case is improving gradually year after year.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

And in relation to the guidance for the three operating companies, we clearly don't give that and we are not intending to do that. I have said publicly that I would expect Iberia to make a small operating profit this year and we haven't changed our view on that.

Jarrod Castle - *UBS - Analyst*

Okay. Thanks very much.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Thank you.

Operator

Neil Glynn, Credit Suisse.

Neil Glynn - *Credit Suisse - Analyst*

Good morning. Just firstly very simplistically, your forward booking levels for the third quarter can you quantify how much at this point you can see and how this compares to last year?

And then a second question more a question on the quality of future earnings. BA seems to be very close to making a profit again in the first quarter which would mean hopefully four quarters of profitability like we'd seen pre-crisis. Willie, as you think over the medium term do you envisage a point where each carrier within the Group is profitable in each quarter to ensure optimal returns or how do you think in that regard?

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

We see no change in the trends on bookings, so there is nothing -- when we look across the network and across the three airlines we don't see any change in the behavior or in patterns given the visibility that we have which I always caution is limited. So no change in the trend there.

In terms of the quality of the future earnings I'm sure the CEOs, two of them are sitting beside me here, would love to believe that they could do that. But I think Q1 will always be a challenging quarter for the likes of Vueling and Iberia, much more so than I think British Airways. But given the seasonality of the business and particularly the importance of the leisure market, Q1 will always have a significant seasonal impact and I think that will make it a challenge. That doesn't mean to say that they're not going to try to continue to make improvements, but I think it's more challenging for Iberia and Vueling than perhaps it is for British Airways.

Capitalization of tax assets for Iberia through the restructuring exercise. Once we approve the new business plan we will be deciding then by the end of the year if we resume the capitalization of the tax assets related to the losses. And that one will be changing where we see figures and percentages coming through the end of the year figures.

Neil Glynn - *Credit Suisse - Analyst*

Absolutely, thank you.

Operator

Jamie Baker, JPMorgan.

Wenchang Ma - *JPMorgan - Analyst*

Hi, good morning everyone. It's actually Wenchang Ma filling in for Jamie Baker here. So two questions from our side as well please. First one, Willie has spoken well of Richard Anderson in the past, and of course Delta is carrying the industry's water right now in the US vis-a-vis capital discipline. While we understand IAG isn't prepared to identify any buybacks or dividend timing just yet is it mistaken to believe that following in Delta's footsteps is a priority for the management?

And the second question, the Delta and the Virgin relationship is developing very quickly at the moment, the airlines are cross-selling and airport facilities for most of the flights have been combined. Has BA seen any positive or negative pricing momentum that you could attribute to the Delta/Virgin relationship please? Thank you.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Okay, I have spoken positively about Anderson and will continue to do so. We are not necessarily trying to follow in his footsteps. We do like the general approach that he has adopted and the discipline that he shows in terms of capacity and capital discipline, which is very similar to what we've been talking about for some considerable time.

It is our stated objective to get the business to a position by which we can reintroduce and sustain a dividend payment. Andrew is in discussions and we'll do some more with our major shareholders to understand the issues that they would like to see us address in terms of dividend policy. But that's something that we will be developing as we go through this year. And the Board has indicated that the issue of a dividend payment will be something that they will consider at the appropriate time. I think it's obvious and evident that we are making good progress and steady progress towards that stated objective.

In relation to Delta/Virgin it's pretty much -- I wouldn't say it's exactly as we thought but it's as close to that as you can imagine. It is a better competitor. The combination of Delta and Virgin is clearly stronger than Virgin on their own. But we are seeing very rational behavior which is what we would have expected of a business being run by Richard Anderson. So it's developing as we saw, and our transatlantic joint business is performing very well. In fact we are pleased, very pleased with the way the transatlantic joint business is performing.

On the issue of capacity on the transatlantic, because we get a lot of questions about this, we are very relaxed about the capacity that we see in the market. We believe capacity is very much justified by the demand that we see. And of course we point out that in relation to Heathrow much of this capacity has been driven by British Airways principally through the additional of the Austin route and with the operation of the A380.

But I went back and looked at some US Department of Transportation data on transatlantic capacity and specifically the capacity out of Heathrow. And going back to 2007 which was the previous peak if you like so that's before two major events, one was the downturn in 2008 but also the OpenSkies which came into effect in March 2008.

If you look at JFK/Heathrow, the seats in the market according to the US Department of Transportation were 3.922m seats. In 2013 it was 3.777m so we actually haven't got back to the same levels of capacity in JFK/Heathrow as we were in the peak. We are actually about nearly 4% down on the peak capacity whereas passenger traffic on that route, according to the US Department of Transportation, is up 3.4%.

So I think you can see -- and that's actually typical of, if you look at the data that the US DOT produces, it's pretty much the same right across the transatlantic network out of Heathrow.

Now 2008 also saw, as I said, OpenSkies so you saw a transfer of capacity from Gatwick into Heathrow, so if I look at the combination of Heathrow, JFK and Heathrow, Newark, Newark was the area that saw most of the additional capacity following OpenSkies, the total New York and Heathrow seats since 2008 are up 1.5% with traffic up 12.8%.

So again the demand on the transatlantic has been well in excess of any capacity that we've seen there and very much justifies the additional capacity that we've been putting in. And if you want -- the only sort of forward-looking source that is available to everybody was ACO's peak summer 2014 versus peak summer 2013 and ACO data shows that on the peak week London/New York 2014 will actually be about 1.4%, 1.5% down on 2013.

So it's -- I think it's much more disciplined than people might believe. And I think it is important to look back over the trends that we've witnessed in recent years. And I particularly go back to 2007/2008 because I think that was the turning point in terms of capacity discipline being more evident in the industry. And my view is that the industry continues to display that. And where we are seeing capacity increases that capacity increase -- those capacity increases are justified by underlying demand in the market.

Wenchang Ma - *JPMorgan - Analyst*

Thank you very much that's very helpful.

Operator

Oliver Sleath, Barclays.

Oliver Sleath - *Barclays - Analyst*

Yes, thank you. Good morning Willie, good morning Enrique. Three questions please, two on Iberia, one on BA. First on Iberia, now that you've got the new productivity agreements have been ratified by the employee group is my understanding, there are clearly a number of options you've got for implementing and getting to that agreed productivity level.

I appreciate it's very early days, but I wondered if you could just talk a little bit about your current thinking with regards to looking at adding further growth in Iberia or voluntary redundancy schemes or unpaid leave or growth in Iberia Express. Those kinds of levers that you could pull to get up to the new productivity that's been agreed. That's the first question.

The second question is slightly related to that, is I recall that the Iberia employees actually get 4% of the salary cut returned having signed their productivity agreement. I just wondered if mechanically does that mean in the short term Iberia could actually see its employee cost line increase or does that basically get offset by the growth that's been announced so far.

And then the final question just on BA on unit cost you said that BA should be able to do well on unit cost on this year, and clearly that's been the case in the first quarter. Could you talk to a little bit more about the kind of supplier savings, further synergies, potentially more outsourcing, IT integration, etc., that BA could do on its unit costs. Thank you.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Okay, thank you. Well, you've identified some of the things that we are considering in terms of Iberia. There clearly is a short-term opportunity which we are taking advantage of to repair some of the network changes that we made. So if you go back to the capacity reductions that we made in Iberia we said at the time they were pretty blunt because we needed to take very quick action to reduce capacity.

And the capacity that we put back in is very much targeted at improving the quality of the network. So the short-haul capacity is designed to ensure that we've got a good feed into the long-haul network, and the long-haul capacity is going in where we can get immediate advantage in terms of operating benefits with the A330s and improved productivity with the pilots.

Going forward, I think there are a number of options that we will look at which may include some additional voluntary redundancy where a case can be made for that, and I think there is a strong case that can be made. But we've not made any specific proposals in relation to that. And the real benefit comes from the new aircraft that Iberia will get in due course.

So we've a decision to make in relation to either A350s or 787s, but they will significantly improve the underlying performance of Iberia, because of the fuel efficiency that they will get from that as well. And in addition to that we are looking at improved productivity on the non-core activities, the ground handling and the maintenance.

On the salary agreement, you're right the agreement was that they would get 4% of salary back where productivity agreements were reached. So that 4% goes back in from the beginning of April. But it will be offset by continuing headcount reduction and improved productivity. So although the salary will increase, it is going to be offset by the ongoing headcount reduction program.

And it's not just BA, we've highlighted BA's unit cost performance and the fact that it will continue, but you're quite right to highlight opportunities for further synergies. We are doing a lot of work on that. We believe that scope exists for significant additional benefits through enhanced IT integration. That's a program we are working on. And potential new deals with suppliers where we coordinate and look at common specification of some of our requirements.

So you get some leverage through scale but the real leverage you get is when you have common specification and that gives you much greater opportunities. And we are going through a program now where we are looking at common specification across the three airlines where we can have product specification. And this includes, for example, the configuration of our short-haul aircrafts, the BFE, buyer-furnished equipment, even [SCNs] on the aircraft. So that's a program that will deliver benefit going forward, so a lot of activity behind the scenes in relation to that and we'll give you further detail on that as we go through the year.

Oliver Sleath - *Barclays - Analyst*

Great thanks. And just following up on that on the short-haul reconfiguration, I recall that BA was planning to start that in around this time, so how has that kicked off?

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Well, Keith is here so I'll just ask him to --.

Keith Williams - *International Consolidated Airlines Group SA - Chairman, BA*

Yes, so we've been looking at a number of aspects of short haul. As you know what we said at Investor Day last year and previously is that we intended to return short haul to profitability at both Gatwick and Heathrow. We are making significant progress but part of that progress was related to the A320s going down to Gatwick and changes in configuration. We expect to be announcing that -- more detail of that very shortly.

Oliver Sleath - *Barclays - Analyst*

Great, thank you very much.

Operator

Robin Byde, Cantor Fitzgerald.

Robin Byde - *Cantor Fitzgerald - Analyst*

Hi there, morning, all. Just two from me please. Firstly, can you just provide some guidance on gross CapEx for the full year?

And then secondly just on deferred tax and the tax rate, I see that you're going to review deferred tax arrangements in the second half. But can you guide at this stage what the effective tax rate will be for the year? Thank you.

Enrique Dupuy - *International Consolidated Airlines Group SA - Group CFO*

Yes, in the case of the CapEx for year 2014 as we said we haven't changed the message. As we said in last year's Capital Market Day what we are expecting is a figure in the range of EUR2b for the Group.

The average tax rate that we are considering will be in the range of 25% but that's going -- as you probably know we discontinued capitalization of tax rates for Iberia through the restructuring exercise. Once we approve the new business plan we will be deciding then by the end of the year if we resume the capitalization of the tax assets related to the losses. And that one may be changing when we see figures and percentages coming through the end-of-the-year figures.

Robin Byde - *Cantor Fitzgerald - Analyst*

Great that's clear, thanks very much.

Operator

Andrew Lobbenberg, HSBC.

Andrew Lobbenberg - *HSBC - Analyst*

Good morning, everyone. Let me ask a question if you don't mind about India. I think Enrique spoke about trading being a little bit soft there and obviously part of the solution will be taking the 787s there. But how are you thinking about the opportunity from that market? What is the potential? And when might it happen that you can do some form of meaningful partnership with Qatar? And is there any possible local partner in India that you could use to strengthen your position in what naturally could be a strong market?

Could I ask a second question about APD? The government made some changes to APD lowering APD for long-haul routes. I think you were remarkably cautious in welcoming it, but will that have any impact on your unit revenues looking forward.

And then a third question if I can be that greedy about the rebranding of Iberia, having gone through a very tough time and a lot of strikes and instability, is there a sense in Spain that the rebranding is changing the public perception of the Company, and when does that feed through into real underlying numbers and unit revenues? So India, APD and Iberia rebrand.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Okay. The -- I'll take them in reverse order. The Iberia rebrand is going very well. The work that they've done has been very well received. The standing of the Iberia brand in the Spanish market has significantly improved. As you would expect it was clearly being impacted by the turbulence around industrial action and restructuring. So we are actually very pleased. I was somewhat concerned about the timing of the rebranding. I thought it might have been a little bit early. But I think Luis actually timed it perfectly. And that's something that in due course will have an impact.

But more importantly is the work that Luis and the team will be doing on revenue management which as we've indicated to you we believe is an area of opportunity for Iberia. So they have recruited in some new management into the revenue management area and have taken in a few analysts as well. So you should expect to see a gradual improvement in that, but I think longer term it will have significant benefit.

On APD, I didn't welcome it. I criticized the government. I thought it was window dressing. It actually has very little if any impact because it's only on the longer bands I think overall affects in total about 8% of passengers flying in -- out of the UK or into the UK if they are returning out of the UK. So it's a very, very small adjustment that won't have any real impact. The real impact from APD only comes about if the government gets sense and scraps it.

And on India, one of the points we've always made is that the British Airways network into India doesn't really need a local partner because there is very strong O&D demand into the gateways that we serve, so we serve five cities. So we don't really -- we've never seen the need to have a domestic partner, but I think the Oneworld alliance were keen to have a domestic partner and we saw that as being positive for Oneworld and potentially having some minor benefits for BA.

So there is no work going on at the moment about a domestic partner in India. What we have said is that Qatar clearly gives us an opportunity to serve destinations in India where we don't serve direct. They have a big network there. I think India still is going through a bit of turmoil. The industry there continues to struggle. Tata Air Asia has just got approval to launch. It's taken them quite a long time. I think the process has been much more bureaucratic and challenging than people understood. And I think that sums up the challenges that everybody faces in that market.

So we see India being principally for BA a market that they serve directly from Heathrow, and some additional benefit coming through working with a partner into other cities in India that we don't believe we can service efficiently on a direct basis, even with the 787. So the five gateways we serve in India have strong O&D demand and don't require a local partner. There are some other cities that we would consider in due course, but we've nothing planned at the moment.

Andrew Lobbenberg - *HSBC - Analyst*

Okay, that's good, thanks. Can I just follow up on the relations with Qatar you've got the code-share partnership. What is the pace or what is the prospect of that developing towards a revenue or profit share structure or is that going to be a very slow burn?

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

The thing I would say about Qatar is Akbar al-Baker makes very quick decisions, so if they want to move quickly they can probably actually move a hell of lot faster than we could. So there is opportunities there, but at the moment we are focused on other areas where we want to ensure that the potential is being developed.

So as I said our principal focus for British Airways this year was to ensure that they would deliver on the unit costs performance and unit cost reduction that we believe is essential to underpin long-term viable profitability for the business. So we are having very good dialogue with Qatar the relationship with Qatar is very positive. And I do that as a relationship that can be developed for the future, but we are not pushing hard on that at the moment. But if something were to happen I think we could move quickly, certainly on their side they are able to move very quickly.

Andrew Lobbenberg - *HSBC - Analyst*

Okay, great. Thank you.

Operator

Suzanne Todd, Morgan Stanley.

Suzanne Todd - *Morgan Stanley - Analyst*

Morning. Can I come back on the very first question about depreciation and impairments? From the Capital Markets Day last year you were guiding for depreciation of about EUR1.1b in 2014. Did that guidance include a buffer for these impairments that are coming through or should we think about calibrating the EUR1.1b upwards to include maybe say about EUR100m for impairments this year? And secondly, could you give us just an update on the progress of the merger synergies between BA and Iberia?

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

[Clearly] the depreciation that the figure we gave you didn't include the adjustment of the depreciation policy on the 747, and as Enrique said that's principally a view on the residual value of the 747 so we've reduced the residual value outlook for that. So that is in addition to previous guidance we gave you on the depreciation.

On the merger synergies, yes, we are making good progress. As you know, we delivered EUR460m gross for EUR29m net last year. We've got a gross target of EUR650m for next year 2015 which is about EUR600m net. And for this year our target was -- our old target was EUR470m but given that we had significantly exceeded our target in 2013 we'll be pushing to exceed the target that we had set for 2014.

So good progress there, and we are -- as I mentioned earlier we are working on additional measures that could see future benefit coming through beyond the original targets that we'd set (background noise) synergies and they principally relate to deeper cooperation on things like common specification of products, some potential additional cooperation and outsourcing on back office activity and the work that we are targeting maintenance as an area that may have potential opportunities for us.

But it's sort of beyond the -- it's not going to be in this year and probably not in 2015 but would start coming through late 2015 into 2016 that sort of period but good progress being made on the merger synergies.

Suzanne Todd - *Morgan Stanley - Analyst*

Okay, and just on the impairments if you can give us just a bit more color. That EUR23m in the first quarter, can you give us any color as to the similar level we should expect to see in each quarter going forward from what you can see in terms of (inaudible) that you plan.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Well, it will clearly decline as we start retiring 747s, so we are planning to retire 747s through this year and next year. So the actual amount reduces with the reducing number of 747s in the fleet. So I think we had at the end of the quarter, end of March we had 49 747s. From memory I think we were targeting to have 44, 45 at the end of this year. And then we'll retire more 747s next year. So the absolute figure reduces as we retire the 747s.

Suzanne Todd - *Morgan Stanley - Analyst*

Thanks very much.

Operator

That will conclude today's Q&A session. I would like to turn the call back to Mr. Walsh for any additional or closing remarks.

Willie Walsh - *International Consolidated Airlines Group SA - CEO*

Okay, thank you very much, everybody. We look forward to talking to you at the half year.