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Earnings Call

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PRESENTATION

Antonio Vazquez - *International Consolidated Airlines Group SA - Chairman*

Thank you very much for being with us in this first-half result presentation.

It's really nice to be here talking about the EUR555m, more than 140% increase in operating earnings, and the Company on track for the result that we want to get on the year. And we are very happy -- from the Board and management point of view, we are extremely happy to see that all the homework that we have been doing for the last -- during the last few years is giving proper dividend right now.

So I give the floor to the management for you to have all the flavor of the result. Thank you very much and thank you for coming.

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

So good morning, ladies and gentlemen.

Again here to present you what we have to label as a very positive set of results for the second quarter, with an operating profit reaching EUR530m, which is EUR150m on top of last year figure. And for the first half, the difference, the gap is getting to EUR325m. So it's making us position ourselves in a very solid track to be able to reach our full-year result, which as you know are about EUR2.2b of operating profit plus.

So this time we've been completing a little bit this chart, because we want to show you not only the unit revenue and costs that we have been achieving through this quarter. In constant currency terms, we think that's only part of the story and we want to show you how those are being converted to euros at the rate prevailing in the quarter, and it's showing some very significant impacts.



So in constant currency terms we are showing, as usually, this figure of minus 6.6% for passenger unit revenue in constant currency terms. And then when we get into the reported terms, we see that the figure changes dramatically. It gets to plus 5%.

On the other side we are mentioning again, as usually, that our ex-fuel unit cost performance for the same quarter has been minus 6.9%, an improvement of 27%. And again, we are showing that in real terms, in reported terms, it's a plus 3.2%.

So this discrepancy between the constant currency terms and the actual terms is showing something a little bit special that the Group is having, a little bit singular, which is the very well balanced position in the currencies that we are operating in. And that's giving us a very stable type of performance and evolution to this second quarter, and then later on in the year you will be seeing the same.

So when we get to actual total unit revenue figures as they are reported, we are getting to an improvement of 5.3%, and in terms of costs we have been able to tie down the performance just to an increase of 3.2%.

60% of the revenues, approximately, and this changes a little bit through the year, but around 60% of the revenues of the Group are denominated in what we will be calling today strong currencies, so basically dollars and sterling. And this is basically one of the main reasons why we are getting this margin improvement through the second quarter that will be leading us, as you will see afterwards, to an operating margin of 10.3%, lease adjusted, which represents an increase of around 2 percentage points against the same figure last year.

So these are a little bit of the headlines that I wanted to transmit to you, on a frame of growth which is very much the same as we mentioned in previous quarters, which is ASK growth 5.5% for the full year.

So if we get on the operating profit chart for this quarter, we are using here the traditional metrics, the ones that we have been using before. So [EUR54m] of the improvement of the EUR150m improvement is related to net positive ForEx impact (company corrected after the call). And that of course is very much related to what I was just saying about the high percentage of strong currencies on our revenue.

The remaining improvement, quasi EUR100m, has to do with what we traditionally call in a slightly synthetic way, in a slightly artificial way, as constant currency terms. Because the money that we are bringing to our pocket is not a plus EUR96m; it's a plus EUR150m.

So talking about these constant currency terms, our passenger revenue figures have been, of course, based on the capacity increase, the ASK increase and the price/mix, in this case red, deteriorations that we've been going through the quarter.

Non-passenger revenues have been more or less constant against the previous year. And of course, we see a significant improvement in constant currency terms, dollar fixed, of quasi EUR200m against last year figures. Of course, the capacity increase makes us consume more tonnes of fuel, and that's why ASK represents a red figure.

We are going to be talking much more about ex-fuel cost performance in the following chart, but as a whole you see a lot of greens there, a lot of blue ones there. The capacity impact of course has to be red, because we are increasing all the time. But the quality of those costs in terms of unit cost performance is very much green. We are going to be talking specifically about that point in the following chart.

Here. So this is basically how we've been performing on constant currency terms, again with this limitation on the concept. But the figures that we have been getting in terms of improvement is a substantial one, is a minus 7% improvement across the different cost items.

Of course, this is a very high figure. It's going to be evolving through the following quarters. We cannot say we are going to get another 7% next quarter, but there is a lot of these improvements that is becoming structural and I will be telling you about them. Okay?

So employee costs, we've been achieving productivity increases in the three companies, and that's very important. So someone was saying, and I just I would say repeat it, we are growing 5.5% with the same number of employees in the Group. So that's a very important underlying structural message, and this is valid for the three companies.



So in terms of Iberia, of course, they are going through their transformation plan, now the plan de futuro in this new stage, and the improvements in terms of productivity and the employee costs are being substantial. And there is more to come. So this is a recurrent process that Iberia will be undertaking, with the help of redundancies and growth in the next quarters and years. There's more to come here.

What we show is again, I would say, is a significant improvement based on one side on redundancy programs that will be driven in the next quarters through Group programs as the global group service unit that we are setting, and that will be concentrating most of the back office levels of the companies of the Group. So that will be a source of productivity improvement and labor cost reduction in the next future for the three companies. And that will be involving, and we are starting with that one, areas as IT as well in a very significant way.

So British Airways has that, and of course has the densification of the short-haul fleet as a source of productivity improvement and unit labor cost improvement.

For Vueling, Vueling is small still in terms of the impact for the whole Group. It is still, I would say, a negative -- it's a positive productivity; it's a negative in terms of employee costs. And it's just rolling over the first 12 months of their new bargaining, not so new, bargaining agreement that was closed by the end of the third quarter last year. So we will be getting to normality in Vueling since the beginning of the fourth quarter of year 2015.

So, apart from these employee savings and productivity improvements, we are having also good news on the rest of the supplier side. So as you see, there is no red or very little red. So it's about a flat performance against last year or it's about improvements.

And we have improvements, for example, in handling and catering supplier costs, and this has to do a lot about new contracts that we are now undertaking on a group perspective and with a group bargaining power. And that's affecting more and more airports now and catering providers, so that's basically good news, and they are recurrent good news. There are also some one-offs having to do with better operational performance in our main hub airports, and that has been driving less penalties in terms of lost packages and things like that.

In terms of other supplier costs, we are flat in engineering. We are more or less flat in landing fees. This is about inflation in landing fees. There is some good news coming here, probably. We cross fingers, but the Spanish landing fees maybe, maybe will be heading into a negative cost -- unit cost performance since the beginning of next year. There is big debate in Spain about it, but I think there are grounds to think that we are going to be getting into an around 2% reduction since the beginning of year 2016.

And then selling costs, also significant improvements, both in terms of marketing costs and also supplier costs with the third parties that we are facing also on a group perspective. So a significant part of these selling savings will be also kept, will be also recurrent.

A very significant increase in IT and others. That's also very much related to the new Group initiatives that are behind the new GBS type of startups, and also the new IT initiatives which will be provoking a significant outsourcing mechanism of our IT activities through the follow year.

Ownership, this is a very interesting one. So as you know, we are -- and we are going to explain a little bit about it in the following chart. We are confirming deliveries of new aircraft. Most of them are related to fuel replacement, but at the same time we are making some decisions about extending the life of some assets, fleet assets and non-fleet assets.

Non-fleet assets, for example, we are extending the life of our JFK in New York facilities at the terminal, and we have entered with the Port Authority an extension agreement for seven years. So that's extending the average life of one significant asset we have there.

We are evaluating constantly the adequate average life of our fleet in a way we can keep a more or less stable average life. And the more or less stable average life that we like, we have been talking about it in the past, is between 10 and 11 years.

So in the same way we are bringing new fleet, we are also thinking about extending the life of some old fleet, which shows us taking the decision in respect of extending life of the A320 fleet. And we are continuously revising that one. And that will be bringing depreciation probably to lower levels in the following quarters and years.



So, lots of things moving. We are basically tackling every possible front and battle of cost saving. So there is going to be more of this good news in the following quarter, probably again not at the pace of 7% per quarter.

And this is how the fuel bill will be looking like in the next quarters. Remember, it's very important how the pattern of improvement in fuel costs is going to be accelerating in the next quarters. We said Q2, and that has been a headwind that we have been going through in this quarter.

Because of the way the hedges were unwinding through the calendar year, Q2 looked not very good, and in fact it had, in terms of hedging dollar, a negative impact against us. We thought it was going to be 4.2. So it has been about 3, so a plus 3 instead of a plus 4.2 or so we forecasted last quarter. But this is getting better and better through Q3, Q4 and then the following year. So you see Q3 we are getting into again positive, so positive means saving territory, minus 5% saving in unit terms.

This chart is not regarding the operational improvement. So sometimes you will see figures that improve these ones because of the operational improvement that we are getting through new seats and new procedures. This is just price. But then the minus 5% will be getting to minus 16% by the end of the year, and then the 20s and 25s will be something probably more common through next year.

So this is a little bit of look, there is more to come. Because of hedges and because of dollar, we are not having this big windfall positive impact. But that has allowed us to focus on non-fuel cost homework, and in some ways that's something that's going to be helping us in the long run.

Capacity for this year and the following quarters, not big news on this one. So, as you know, the capacity this year is basically very much related to what Vueling is doing, what Iberia is doing, not so much in the capacity increases of British Airways, which as you well know is going to be very, very flattish in the long-haul and maybe around 7%, 8% in the short and medium-haul.

So the big stories in terms of growth are about Vueling and Iberia. As you know, Iberia is growing, recovering routes that were basically discontinued on the crisis. The change in productivity and costs for Iberia has been such that most, not all, of these routes will be recovered efficiently.

And we'll talk a little bit more about this concept later on, because there are going to be also new routes and past routes that Iberia didn't dare to operate just, I would say, five years ago, and now are appearing in the horizon as potential sources of additional profits and returns.

And for Vueling, it's about continuing with their growth pattern, and in a very similar way as they have been doing in the last exercises. As you know, they are based on Spanish growth, of course, as one of their core businesses, but also now they are exploiting opportunities of growth in areas, in places, in countries like Italy, France, Benelux and other areas. So that's a continual exercise that Vueling will be making through the next quarters as well.

As a whole, the growth for IAG will be 5.2%, instead of the 5.5% that we were envisaging. Small changes, improvements that have to do with cancellation of, I would say, low yielding routes as the ones that British Airways are doing in some fuel related routes, as you will see.

So this is the way the growth is being driven this year. For British Airways, it's about the new route of Kuala Lumpur, mostly. And then there has been some discontinued routes in Africa and, as I said, other disrupted routes because of fuel, mostly.

Sector length has been reduced just because of the growth of the short-haul, densification of short-haul, which is also why the average aircraft gauge has been increasing, on top of the new A380s, of course. More movements in frequencies, and basically not a lot of novelties with the exception of what I said on Kuala Lumpur and some additional frequencies and changes in Tel Aviv and Larnaca.

For Iberia it's new routes, but we prefer to call them restored routes because they are routes that Iberia has been operating in the last 15 years, for example. So, well-known routes where we have a strong, I would say, knowledge about the client base and also about the yields and prices that we can achieve. So that's the source of this increase of 10.2%. And the rest is basically very flattish. Frequency changes in some places, Mexico, Santo Domingo and also Canary Islands also.



For Vueling, for Vueling, as I told you, it is a similar pattern of opening new routes, and this is basically related to what they are doing in, as I said, Italy, France and Benelux. And a very similar pattern about stage length, aircraft gauge, a little bit bigger because of the introduction of 321 aircraft.

So we are getting now to revenues and unit revenues related to growth. We are going to still be showing this chart, which is the constant currency one, but we are going to maybe complete it with some additional information because, as we said, this brings only a partial explanation of what's happening.

So in terms of growth, what we are seeing is stability in North America, significant growth in Latin America which has to do basically with growth for British Airways and also Iberia in the areas as Brazil. Some capacity adjustments happening in Africa, Middle East and South Asia, and basically they have to do with these fuel routes that we were talking about. Some capacity increases in Asia, and this is the new route of Kuala Lumpur and some increase in capacity in Singapore and Hong Kong.

Significant improvement in Europe in terms of capacity, 14.4%, and this is basically driven through these three tools. On one side it's mostly Iberia Express, a very low cost producer of the Group which is taking a significant portion of the short-haul growth for the Iberia Group. Very efficiently driven and very low cost, marginally low cost driven. So this capacity increase for Iberia, Iberia Express in this case, is a very efficient one.

The other contributor is Vueling, of course. And Vueling, as you well know, has one of the lowest unit costs of the whole scope of low-cost operators in Europe but, again, I would say an efficient source of intra-European growth for the Group. And for British Airways, it's mostly related to densification of the aircraft, so the marginal cost of that exercise is really a very small one.

So you can be a little bit worried about this 14.4%, but the message that I wanted to transmit to you is very cheap capacity for IAG Group.

In terms of RASK, so we are seeing a minus 3% in terms of North America. These figures, as you may understand, are very much influenced by the ForEx impact. So, because of we are selling in dollars plus sterling up to 60% of our global sales, of course there are pressures in revenues considered in a local basis, in a constant currency basis. The reality, as you will see in a further chart, is we are getting much more money in euro terms for those sales that appear here negative in constant currency terms; in euros, much more money.

So, Latin America again falling 7.8%. This is basically Brazil, a little bit of Venezuela still but mostly Brazil. And we have already taken some decisions of cutting capacity in Brazil, just to address the situation.

Africa Middle East weak, and weak despite we have been reducing capacity by around 4%. And as I said, it has very much to do with oil routes, as Lagos, Abuja, Angola, etc., etc., and that's something that we think will be bottomed through the remainder of the year.

Asia Pacific, it's about mixed performance. We are growing there. This is Kuala Lumpur. Kuala Lumpur new route is dragging a little bit the average of the unit revenues, because of opening this route. We have some good performance. For example, Japan is performing strongly there. So, mixed result, mixed airport performance in Asia Pacific.

Finally, domestic. Domestic, again a mixed picture and this is something that I want to transmit to you. I think it's important. A very strong Spanish market, very strong, and that's affecting very positively through the summer, Q3, our Spanish companies, both Iberia and Vueling.

And a weaker, I would say Scottish market, a weaker UK market, having to do of course again with the old oil route ones. So that's why it's dragging down unit revenues, but it's in some way disguising a very positive performance coming into Q3 for the Spanish market.

This, I will just go through it very quickly. It is the one where we explain when there are differences in behaviors between our different class segments of clients. So in this case it doesn't bring additional information.

Long-haul, both premium and non-premium, very similar performance.

Short-haul, a little bit of an adverse performance for Iberia in the short-haul because they are growing above 20%, so that growth is going to be probably reduced in the following quarters. Also British Airways but, as I told you, British Airways unit revenues are counterbalanced in terms of a negative impact by a very small marginal cost coming through densification.

And this is the story told in a different way. So this is a story where you come to the money that we are making and the money that being the positive in our bank account, our euro money. Okay?

So when we get to the North America performance, instead of a minus 3.5% we get a 13% plus. Of course, it has to do with -- remember I told you 60% of our revenues are done in hard currencies. In the case of North America, it's above that 60%, a very significant part of our North America sales. Maybe everything with the exception of Iberia sales done in Spain is hard currency related. Look at the jump. So 12.9%, but our cost in real terms is growing 3.5%. Okay? So that's a different way to look at figures and the market.

Even Latin America was showing ugly in terms of constant currency terms, in excess of minus 7%. In real terms, the money that we are earning through revenue, the revenue figure that we showed in the first page for Latin America is 3.8%. For Africa Middle East, it's 7.4%. For Asia Pacific, it's 8.2%. For Europe it's minus 1%, but remember our marginal costs growing into Europe are not the average plus 3.5%, are much less, so even the growth in Europe is having a positive contribution.

So this is a different way to tell the same story, and this one is one that we are going to be repeating, because in the next quarters we are going to see also a very significant currency impact that we need to share with you.

This is about the company by company performance. So for British Airways it's sterling, for Iberia it's euros, for Vueling it's euros. What I want to emphasize in this chart is just a couple of things. I think I'm probably boring you now. This is getting a little bit too long.

So margin improvement, operating margin improvement. So good news for British Airways, 2.1 percentage points on top of last year; good news for Iberia, 2.4 percentage points above last year; slightly worse news for Vueling, a little bit below the figures of last year. We have to say Q2 has not been a good quarter for Vueling, but we are not too worried because of two things.

First, Q2 is not the preferred quarter for Vueling. Vueling has a very, very steep, marked seasonal pattern. So let's wait for Q3. The other one is we see Q3 improving for Spanish companies and we see booking improvement. So we think that this figure of Vueling is going to improve through the following quarters.

Again, the second message that I would like to share with you is about productivity improvements and CASK ex-fuel for the three companies. So as we told you, employee cost per ASK improvements, very big improvements for Iberia still. So the impact of the restructuring exercise is the same flow and will flow through their accounts in the next quarters and years.

For British Airways, again good news. For Vueling it's not good news until we roll over this one year, first year big impact of the new salary agreement. That will be vanishing down in Q4 this year and into next year.

So this is one that we'll be bringing more and more, because we need -- we want to follow very closely our return on invested capital. So what we are saying here is for IAG there is an improvement in the operating margin. It's 10.3%. It was 9-point-something last quarter. This exercise is done with the four previous quarters on a rolling 12-month basis. It gets a full-year exercise for that. It's improving at the Group level 2 percentage points.

And in terms of ROIC we are getting to 9.1%, which is getting closer and closer to the 12% target that we told you we were wanting to reach, and it's going to come soon. So improvements for British Airways, improvements for Iberia, and Vueling has a minor reduction but the figure is still the highest of the Group, 11.9%, so they are there already; Vueling is there.

Balance sheet. So, basically three messages. Cash is improving, and that's having to do with three issues. One is translation. Our sterling cash has more value in terms of euros. The other one is our results of the second quarter. They create cash. And the third one is our CapEx for this quarter

has been slightly lower than other quarters in the past. So cash good for the Group, good for the three companies; for the four companies including the holding company.

The other one is gearing, gearing on an accounted basis. We don't like it so much as a concept. It's improving, so it's getting to 43% from 51%. But it's always affected by these accounting issues, which brings volatility to these figures.

So, the last one here is about the unwinding of the hedges. So when you have hedges that are below market in terms of worsened market, they create negative reserve. When you use them, you release reserves again, positively. The good one here, the one that we need to follow is the flows one. So adjusted net debt to EBITDAR, that's real money, and that's improving from the 1.9 by the end of the year to 1.5.

And this is -- so bringing three interesting charts, this is a very interesting one, which are showing a little bit more about these conceptual issues about ForEx that we have been trying to explain to you in the last, I would say, half an hour.

So this chart shows -- bridge shows net, Europe to US, the transatlantic network, but not only British Airways bookings but full CRS bookings, so the whole market for British Airways type of network and competition. It is not the full story, because you know CRSs are just, I would say, the bookings that are made through the travel agents. So there are others that explain, other companies or regions which are not in these charts, but these may be getting to 70% of the total bookings so I think it's a reasonable sample.

You may have other sources of data to complete the picture. We think it's a quite reasonable sample of what may be happening, so how these bookings -- so this is not prices; this is volume. This is tickets. Okay? Number of tickets has been evolving through this first half of the year, how we are looking into the third quarter.

So one would say, look, all these bookings generated in the US because of these guys are rich now, with this strong dollar, should be rocketing. And those, that's the blue line. So the blue lines show how the bookings generated in the US and paid in dollars have been improving through Q1 and how we see them for the third quarter.

So it looks as probably a regular behavior, stronger dollar ramping up these bookings. So there are differences, for example, from the way customers are flying from the US to other continental Europe destinations and the ones that are flying into the UK. And one would say, look, you are flying into Europe, a cheap euro denominated Europe, you are getting more. You're flying into the UK, a not so cheap sterling denominated country, you are getting less cheap. So, regular pattern.

And then the green one is the other way round, flying to the west. So, again, we would be saying flying to the west out of the euro base is expensive, so it should be dampening bookings, and that's what we have seen in the first quarter. And then there is still some type of shaky performance through Q3 and beyond.

With the exception maybe of the dotted line, and the dotted line is the rich UK travelers with the sterling. So that's showing some improvement through the summer. Again, this shows type of expected patterns that we, all of us, could envisage.

And then let's show the second quarter, because we call the second quarter a dislocated quarter. So by the end of March we were saying, look, this is how it shows. We can recognize April, because April was Easter holiday. So we are getting the money on March because in respect of last year comparisons, March was the Easter holiday this year, so there was some advance bookings that were falling in March and that were lacking in April. So, April, we told you it's looking oddly weak. Okay?

But then we have seen more weakness in May and just I would say a mild recovery through June. So Q2 has been a very strange month -- quarter, sorry, in terms of booking patterns. And what we feel is passengers have not responded to what would be the normal trend because of the underlying type of market and currency situation.

And when we compare this ugly quarter with what has happened in other areas of business in the US, it's very much the same. So this big dip in the blue is happening in most of the business -- consumer related business in the US, with the only exception of restaurants. So all these savings



that the US people are getting because of fuel savings and more dollar related money in their pockets, they haven't been spending it. That seems very strange.

Okay, but it shows a little bit what's happening with currencies and why we need to bring the figures both in constant currencies but also in actual terms.

And then a little bit of an advance of announcements that we are going to be producing in the next days. I want to prepare you a little bit about what we are going to be saying, because in general terms it's business as usual. So, please, some significant fleet decisions by Iberia which we have already prepared ourselves to undertake a couple of years ago, it's replacement. So it's replacement on the A320 fleet for Iberia, but also for the rest of the group, Vueling, British Airways.

And that's again business as usual and is taking the advantage of, I would say, a very attractive deal with IAG, a group NEO deal with Airbus. And we are executing batch by batch, and this time it will be starting with 20 A320 NEOs. And a very similar exercise in the case of Iberia with the 350-900 fleet, which will be substituting the 340-600. So, again, these will be coming through 18, 20, and we have been telling you about the normal process of these renewals.

The red one is a new one. The red one is a new one. And it has to do with what we advance. We are envisaging some very interesting growth opportunities in the long-haul for Iberia with the new cost structure that they are benefiting now from.

So, very attractive opportunities in terms of opening new routes, both on the Latin America area but also, and this is a novelty, in some cases to Asia. We'll be giving more details very soon, and I don't want to disclose too much of what will be disclosed by Iberia in the next days.

And then, these renewals plus growth positions are not going to be disturbing the pattern of growth that we have for the Group and the one we had for Iberia and we announced one year ago. So we were saying the long-term average growth trend for Iberia should be also, as in the case of British Airways, 2% or 3%. In this case, we were mentioning 2%. And of course, after these big prices adjustments that we did through 2011 and 2012, we will be recovering those routes that now are going to be profitable again.

What we are showing now is the green one. So we are going to be accelerating, but just only mildly, the long-term pattern of growth for Iberia. And this will be considering the new additional five A330s that we will be using in the next three years for this purpose.

So, Aer Lingus, I'm not allowed to do anything but reading so I'm going to read. IAG has waived the 90% acceptance condition and now then the offer is unconditional. Level of acceptance we have received has reached 62.48%. We have extended the terms of the offer up to August 18, and we are saying today there's not going to be further extension. And we remind that Ryanair's acceptance remains a condition for the offer to be a final one.

So, guidance. Guidance for the full year, in terms of operating profit we are retaining the guidance. We are reconfirming you that we are going to be getting this EUR2.2b plus, on a fuel bill scenario that we still are rounding in the range of EUR6b and with a capacity growth for the calendar year that will be getting to around 5.2%. And that's basically it.

QUESTIONS AND ANSWERS

Andrew Barker - *International Consolidated Airlines Group SA - Head of IR*

-- state your name and affiliation. And I see the first hand up is Jarrod from -- and then we'll go to James after that.



Jarrold Castle - UBS - Analyst

Thanks, Andrew. It's Jarrold Castle from UBS. Three, if I may. You spoke quite a bit about the passenger business. Can you give a bit of color in how you view cargo developing in the second half of the year in terms of yield outlook and volumes, please?

Secondly, I know you probably can't say too much on Aer Lingus, but assuming it closes on August 18, when would you expect a new update in terms of adjusted guidance for incorporation in the Group?

And then thirdly, just I guess slightly related, but Ryanair at the Q1 results had this call for competitors to show the inventory available from the industry and reduce the business that gets done through OTAs and I guess GDSs, etc. So, just any views on that and then just any views in terms of some of your digital initiatives would be appreciated. Thanks.

Willie Walsh - International Consolidated Airlines Group SA - CEO

Good morning, everybody. We have Steve Gunning with us, the CEO of our cargo business, IAG Cargo. So I'll ask Steve to respond to the cargo question and then I'll talk the other two. Steve.

Steve Gunning - International Consolidated Airlines Group SA - CEO of IAG Cargo

Thanks for the question. As you know, we've been saying even at the capital markets day in November of last year that the market is oversupplied with capacity, which has put pressure on yields. We've seen that continue in the first half of this year. We think that there will continue to be softness in the second half of this year. It reinforces the decision we made to get out of the freighters about a year ago.

The other way we've been addressing the yield situation is by pushing our premium product mix. Our premium product mix is up 40% in Q2 versus last year, and that's considerably higher yielding than our general freight product.

So although I think there'll be considerable yield pressure, I think we're mitigating that to a large degree. So you will see our yields at out-turn up about 11% for the quarter, at constant currency down only about 3%, which I think compares favorably. So quarter's been strong, I think, in relative terms, but I do think there will be yield pressure in the second half continue to bear, hence why we'll continue to push on the premium product mix.

Willie Walsh - International Consolidated Airlines Group SA - CEO

In relation to Aer Lingus, naturally we will update you at the capital markets day in November. We will seek to give you some update in advance of that, where we can. There are some issues that -- procedural issues that we'll need to go through. First is with the USDoT, where we'll need USDoT approval to bring Aer Lingus into the joint business. So, that process will take a minimum of 90 days, which technically we can only start once the deal has been completed.

So there's still a bit of work to do, but we are very familiar with the Aer Lingus business. We've got an excellent relationship with the management team there. And they're very keen to move quickly. They're excited about being part of IAG. We're excited about having them as part of IAG. So I think where possible we're going to move at pace. And we're fortunate to have had the experience of the integration of BMI and also the integration of Vueling, and I think our systems are in slightly better shape than they were when we were doing both of those. So we'll update you as soon as we can, but certainly at the capital markets day.

In relation to Ryanair, clearly distribution cost is an issue for the industry and you've seen initiatives from Lufthansa, which I have to say I admire. It's going to be interesting to watch how that plays out. We have deals signed with our GDSs which clearly we will honor, but we are always looking to negotiate more effective deals for our distribution. We will continue to look at ways of lowering our distribution cost.

I don't think we have as big an issue with the price comparison websites and OTAs as Ryanair has. As you know, Michael has waged a war against screen scrapers over the years, so it's not as high on our agenda as it is on his. The issue of distribution costs, because it's one of those supplier costs that we intend to address going forward, is an issue that we are interested in, but it's not something that's at the top of our agenda. But we will be doing our own work.

In relation to our digital activity, we're putting a lot of time and effort into this. We have set up a group within IAG, so we've drawn resources out of the operating companies. And we create now like a taskforce within the operating companies as well, to do specific work activities over a short period of time.

So we're trying to disrupt the normal pattern of digital transformation within our business by giving people the authority to do some work over a short period of time and implement it, and we're just completing the first of those projects. So, we look at an eight-week period where they can effectively operate without any boundaries, and we've also set aside part of our normal IT budget for a digital transformation group.

So we've done this as a sort of -- I wouldn't call it bureaucracy, but to bypass the normal investment planning process so as to allow people to work at pace, working with digital experts in Israel and on the west coast, to see if there are initiatives that could be useful to us. So we've earmarked a part of the IT budget to enable them to do that. Once they identify a potential option for us, then that goes back into the normal approval process.

But we want to be able to increase the pace at which we're operating to take advantage of some exciting opportunities. And you will see some of these coming -- some of them will be, I think, significant in terms of improving customer proposition. Some of them may well be transformational. But a couple of the initiatives we're looking at, at the moment, and we presented these to the Board yesterday, are certainly interesting.

So we're trying to really move at a pace that we've not been operating at within the individual operating companies. And it's great having three very different approaches to this and combining the expertise of the three main airline companies to push this agenda forward.

James Hollins - *Nomura - Analyst*

It's James Hollins from Nomura. Three from me, please. First one is just perhaps you could give an update on how far through your worldwide supplier contract negotiations you are.

The second one is, given the recent sterling move, the move against the euro, are you seeing a good uptick in UK demand, particularly in helping the up-gauge exercise you did on the short-haul fleet?

And the final one is on Vueling, which perhaps you could give an update on, A, how it's trading in Rome; B, are there any further cost initiatives coming through. Clearly it rolls off in terms of that pay deal. Are you digging deeper on any other areas? And are you looking at any other new international bases for Vueling?

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

Okay. Well, Alex is here so I'll get Alex to answer your question on Vueling.

In relation to suppliers, we're targeting initially the big ticket suppliers and we have a very significant number of suppliers. I may get the figure wrong, but just looking at IT, we have identified that we have something like 750 different suppliers in IT across the Group, which quite honestly is ridiculous. So we're rationalizing the supplier numbers in the first case and we've got a number of initiatives going.

So Enrique mentioned IT as a particular initiative. So we're going to attack IT from two fronts, one from a supplier through our procurement people and separately through transformation with our IT people. And you're going to start seeing evidence of that coming through. We'll be making some announcements in the next probably few weeks, certainly within the next couple of months. And then further initiatives planned for later on this year and next year. And again, we're going to move at a much faster pace in relation to this.



So the area that Enrique talked about, IT and others, which is principally around exploiting this new GBS company that we've established, I think you're going to see a lot of value being created there. Some of it we'll see this year, but most of it is going to come through in 2016 and 2017.

And London -- UK demand, yes, UK demand I think is good. Enrique talked about wealthy London people or rich London people. Is that the way you described them or -- so we're very, very pleased with the performance at Gatwick. I think Gatwick for us is a good barometer on the short-haul because, as you know, we've had a significant focus on the profitability of our short-haul operation at Gatwick.

We have very, very good operational performance. I have to say all airlines are suffering from a difficult ATC environment, not just in the UK but across Europe this year. It just reinforces the need for the EU to get their act together in relation to the single European sky, because we're encountering levels of delays this year that we haven't seen for many, many years.

Our operational performance at Gatwick has significantly improved. It's nice that at a time when we're seeing significant improvement in our operational performance, one of our major competitors is seeing a significant deterioration in their operational performance.

So I would describe the London market and the UK market as being pretty good, with the exception, as Enrique mentioned, Scottish routes where there has been an oil impact that is quite evident at the moment, and then oil related which we do believe has dropped off.

And, Alex, do you want to talk about Vueling?

Alex Cruz - *International Consolidated Airlines Group SA - CEO of Vueling*

Yes. Good morning. Good morning. Alex Cruz from Vueling. On the three items, very quickly. On costs, Vueling since its birth has had a continuous cost reduction program, so there's cost being removed on a monthly basis across multiple items. So, yes, you should expect us to continue to remove costs from a number of initiatives. Particularly this year we are making significant inroads in maintenance and in handling, as we close more agreements both across Europe and in Spain. So I am encouraged by our continuous efforts to make reductions on cost.

The crew costs, remember, are a small portion of the total costs within Vueling and we should see, as Enrique was mentioning before, improvements on the comparison versus the previous year toward the end of the year.

Rome is trading well from a commercial perspective. This is the second full year. We're going into the second year and we are seeing improvements on the unit revenues on the routes. Domestic is improving significantly, particularly more the south than the north, but we have a lot of capacity on the domestic -- on the south domestic routes. So we're encouraged by that as well. The fire -- the effect of the fire, unfortunately, has put a small blip on May and June there, but we think that Rome is definitely a market that we need to continue investing and growing into.

And finally, on an international basis, we are not expecting to do any more Rome style multiple aircraft based investments over the next year or two. We might open up, tactically, another airport or two in Europe, once again single aircraft, to improve flight schedules as we have done before in Brussels and in Amsterdam, etc., etc.

Oliver Sleath - *Barclays Capital - Analyst*

Morning. It's Oliver Sleath from Barclays. Three questions, please. Firstly, on Iberia, it feels like long-haul is outperforming short-haul a bit at the moment. I guess that's why you've changed the growth rates around. Do you have any sense for why that is? Is that relative to the competitive environment, further demand on LatAm than intra-Europe, or the cost base falling faster than you would have expected onto long-haul?

Second question. We've obviously got a much stronger dollar and a lower fuel environment and I wondered, does that make you review some of your CapEx commitments within the existing order book? We've obviously seen a little bit of that with the A330 CEO order this morning, I guess. Is that something you're doing more work on generally?

And the third question. On all the synergies in the GBS, which it looks like the integration is working well there, do you see opportunities to bring some other functions up to the IAG level, for instance, something like maintenance? Could we ultimately end up with an IAG Engineering rather than separate OpCo engineering? Thanks.

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

Okay. Luis is here, so I'll ask Luis to comment specifically. But I think some of the short-haul issues that we've encountered, as you know, we made an effort to repair the Iberia network, and part of that was to reintroduce some additional short-haul flying to feed the hub. I think the team has had an opportunity to evaluate that and to start rationalizing that again. But what is clear is our long-haul is performing better.

The new routes, Luis, if you want to talk about what you're seeing so far?

Luis Gallego Martin - *International Consolidated Airlines Group SA - CEO of Iberia*

Good morning. Yes, I think the long-haul is working very well, but it's true that we put a lot of capacity in the short and medium-haul because we wanted to review the hub. We put more than 20% of growth in Iberia Express and also in Iberia. We review the network but we are now adjusting the capacity there, because the RASK is lower than we expected.

But it's true that the short and medium-haul is helping to the long-haul in order to achieve the profitability that we want there. But the reduction in cost is the same in the whole Company. It's not something that is working better in long-haul or in short-haul. It's something that is working in the same way.

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

And in terms of the CapEx, you're absolutely right. So this combination of stronger dollar, lower fuel prices is allowing us to review our CapEx decisions and we are just, I would say, reviewing them all. For these 320 NEOs, for example, we just last week checked that even at \$600 per metric ton of kerosene and with the dollar at \$1.09, I think was the figure that we used, it still makes sense, it still creates a positive net present value.

So we are reconfirming. In each case we have the opportunity to reconfirm that it makes sense, the investment we are reconfirming. But at the same time, acceleration has little sense now. So, acceleration of renewal of fleet is something that we are not going to be considering so much, so probably it's going to be more about extensions.

So this combination, as I told before, of new fleet that we feel we are comfortable is going to be creating value, plus extension of old fleet in a combined average life would make sense. That's how we are going to drive it. You're going to see both.

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

And in relation to IAG centralization, you've touched on the one that we are looking at, which is maintenance. We've got a project which Luis is heading up. We've created a small team of people from BA, Iberia and IAG, and we're reviewing all of our maintenance activities. We've already taken some decisions in relation to some activity that we'll now need to consult with our trade unions in relation to, but we see this as an opportunity.

And Luis is an expert in this area and I think -- I don't want to build him up too much, but his track record in terms of delivering in Iberia is fantastic. So we have great confidence that we'll be delivering something exciting in relation to maintenance going forward as well. But that will be a new area. We have looked at it, but I think we've taken a new and more enthusiastic approach to centralizing some of the maintenance, repair and overall activity.



Andrew Barker - *International Consolidated Airlines Group SA - Head of IR*

Go to Damian and then Andrew after that.

Damian Brewer - *Royal Bank of Canada - Analyst*

Damian Brewer, Royal Bank of Canada. First of all, could I touch on -- following on from Oliver, given it still looks like even with the extra Iberia aircraft your long-term growth rate CAGR, both for BA and Iberia, still looks as if it's running below GDP, is there a point, particularly given with the experience you've had recently at Gatwick, where you wouldn't just look at life extensions but would look at secondhand aircraft, maybe long-haul as well? If you could talk a little bit more about that.

Secondly, just because of -- following on from the data at the Iberia investor day last year, could you give us an update or elaborate a little bit more on what the flight completion factor looks like across the three operating units this year compared to last?

And then very finally, you've got the denser A330-200s at Iberia, densified BA short-haul. Are there any other parts of the fleet like long-haul at BA or Iberia you would now look at reconfiguration on? Thank you.

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

Okay. Yes, I think the long-term CAGR is -- we're challenging the operating companies in terms of long-term CAGR. We think there is scope, maybe, to introduce a bit more ambition, particularly in terms of long-haul growth. That is something that we will do through the business planning cycle that we're going through at the moment. And it was interesting, we presented our initial feedback in relation to that process to the Board yesterday and that was one of the issues that comes out, that there probably is scope for us to be a bit more ambitious, particularly with the restructuring that we have done.

And I think that's one of the reasons why we were very confident about the new proposal to increase the Iberia long-haul fleet by up to five A330s. And we've gone through a very detailed analysis to support that, which supports not just the addition of the -- additional capacity but the expansion of the network. And we believe that there is more possibilities there, so that's something that we're going to consider as we go through the process.

In terms of secondhand aircraft, absolutely, we have no objections, none whatsoever, to looking at secondhand aircraft. I think it's fair to say, and you'd know this yourselves, that the cost of reconfiguring a long-haul aircraft is very expensive, and that's one of the factors you need to look at very carefully. But I think there are opportunities for us to look at secondhand aircraft. We've never been opposed to it. In fact, we look at that as an option and we always play the secondhand market against the new market to ensure that we're getting value for the deals that we do.

I don't know, Enrique, do you want --?

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

And the 777 is a clear example there. We cannot conclude anything for the time being, but you can be sure we are analyzing different options for the potential substitution, or not, for extension of the life of the 777s. Maybe we change our calculations. Yes, that's an open issue. It's an open matter of debate. And we'll take conclusions before the yearend on that one.

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

In relation -- sorry, your second question was in relation to flight completion?



Damian Brewer - Royal Bank of Canada - Analyst

Yes.

Enrique Dupuy - International Consolidated Airlines Group SA - CFO

I don't know the final data. It's about punctuality?

Willie Walsh - International Consolidated Airlines Group SA - CEO

Yes, it's regularity and punctuality.

Enrique Dupuy - International Consolidated Airlines Group SA - CFO

Regularity and punctuality.

Willie Walsh - International Consolidated Airlines Group SA - CEO

Certainly regularity has, just thinking now, in BA has improved, both long-haul and short-haul. Punctuality in BA has improved. But the main obstacle we're facing in all three of the operating companies is air traffic control disruption. It's having a big impact on BA. I think it's fair to say Alex highlighted this to us last week in terms of the impact that it's having on the Vueling operation, and it's impacting on Iberia as well.

So if we strip out issues that are outside of our control, our underlying performance has improved. But the issues that are outside of our control, and principally air traffic control delays over Europe, are getting worse. And we're seeing more and more restrictions being placed by airports and ATC unions (multiple speakers). And as we said, the trend there is a concern. We'll be taking this up -- and I know the other airlines are concerned about this. We'll be taking this up with the EU Commission because, quite honestly, there's no excuse for some of the restrictions. There is technology in place that could address it.

Densification and changing configuration of aircraft, we look at this all of the time. Very encouraged by the work that we've done in BA, particularly encouraged by the work that we're doing in Iberia, and we're looking therefore to see if there is other opportunities. We are making some configuration changes for premium that we talked about before, introducing this Super high J, and we're confident that that's the right decision.

Keith, do you want to --?

Keith Williams - International Consolidated Airlines Group SA - CEO of British Airways

Yes. The success really of the A320 shows you what new seating can do. As I outlined at the last meeting we had, that the customer feedback on the new 380s has been -- no, 320s has been fantastic. So if you look at the 777-200s as the next example, and Enrique was saying rightly that we're looking at whether we should extend the life of those, and they're about mid-life at the moment, we've got very different seating configurations in economy on our 777-200s. So the 46 777-200s, you've got anything from 204 economy seats down at Gatwick to I think about 134 seats at Heathrow.

Now, a lot of carriers have moved to 10 abreast. We're currently at nine abreast. So you can see anything to 8% to 10% improvement in seating from those aircraft, potentially, and potentially give the customer a better experience at the same time. It's certainly something that we're looking at.



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

One of the other things we've done is we've evaluated our 787 order book and it's likely that we will change some of our 787-9s to 787-8s, and that's for a couple of reasons. We see a better opportunity with the 8 and the seating capacity. The 8 doesn't have a first class; the 9 will have a first class. The configuration that we have the 787-9 in is effectively the same number of seats as the 787-8. So we think, on balance, given the trends we've seen in the market that there's a case for more 787-8s and a reduction in the number of 787-9s.

So we're doing a lot of work all the time, keeping our previous decisions under review and changing them if we see opportunities to do so.

Andrew Lobbenberg - *HSBC - Analyst*

Hi. Andrew Lobbenberg from HSBC. Willie, I think in Miami at the IATA do you spoke about calling for tougher competition from the OEMs, and whilst you seem quite content with the deal you've got on the 330s today, how do you think you can progress more pricing competition in engines and aircraft?

Another big picture one for you is the third runway. I think up until now your policy has been that you thought it would be a great report, which I think most people think it probably is, but that you thought that it would sit on some political dusty shelf. And yet we've got a committee announced out of Downing Street which doesn't seem to have too many people with blonde floppy hair who want an Estuary Airport. So when does your policy evolve?

And a third question, slightly more narrow. You spoke of Kennedy and the terminal and extending that. You're losing a client there with United. What are you hoping to do? Are you hoping to bring the Irish in and tear them away from JetBlue, or would you look to bring Iberia into the terminal to maximize the utilization of that?

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

In relation to the OEMs, what I mentioned at Miami at the IATA AGM was that we believe that there is evidence to suggest that the competition between OEMs is not as strong as it should be and that there are restrictive practices. Now, whether that's an impression or a reality is something we need to test.

IATA agreed to coordinate this activity through the IATA General Council. So clearly we have to be conscious of competition laws and as airlines we are restricted in terms of what we can say to one another, but we have put in place a process with external legal advisors working with IATA in conjunction with individual airline general councils to look at this.

This is a process that will take a little bit of time. But it's clear to us, certainly, as one airline group, and I know other airlines and airline groups have talked about it, that there is a need for a review, at least, if not a complete shake up of some of the OEM practices. So that's work in progress and we'll leave it to the lawyers to progress that in the short term.

On Runway 3, I don't agree with everything that was in the commission report. I thought the analysis undertaken by Howard Davies was very good. I wouldn't expect some of the comments that he makes. I think he glosses over the financing and the ability of airlines to pay. He makes some comments without any evidence to support them. If his comments were true and those airlines make excessive profits at Heathrow, you'd have to question why BMI was effectively bankrupt and why Virgin has never really made a profit.

So we believe that the third runway faces significant political obstacles still. The Prime Minister will have to do a U-turn in terms of comments that he made prior to the 2010 election. There are strong personalities within the Conservative Party who are opposed to the expansion of Heathrow. There are clearly some personalities who are in favor of it.

So I think the political debate is going to move forwards and we'll watch that with great interest. The next hurdle will be how the hell are they going to finance this, because quite honestly the project as envisaged by Heathrow and the Commission to our mind is way over the top. It's inefficient infrastructure, extremely expensive infrastructure, and we don't see how it can be financed in an efficient way.

Our position is we're not going to pay for it. So if they think we're going to sit back and just say, yes, we'll happily pay for this, we won't. And I think we're in a very strong position because we didn't support this initiative. If you remember, we supported a different initiative back in 2009, and following the coalition government decision to oppose the building of a third runway back in 2010, we went on a different path.

So we did not support the building of a third runway or any of the initiatives being reviewed by the Commission. We did participate. We were invited by the Commission and were pleased to have done that. But we see this as a project that remains shaky on a political basis, big environmental and local challenges and huge challenges from a financing and cost point of view. So I still remain skeptical but maybe I should be a little bit more positive in my outlook, but I still remain skeptical about the deliverability of any runway expansion at Heathrow.

And with JFK, yes, United, as you know, have given up their slots or sold their slots, have traded their slots with Delta. They will withdraw. One option that we will look at and are actively considering is Aer Lingus getting back the United gates or domestic gates and Aer Lingus operations into JFK, because of the pre-clearance at Dublin or domestic passengers, they're effectively domestic passengers. So that could be an easy solution for us.

There are other airlines who have expressed an interest to us in taking up the gates. So we don't see that there's going to be any issue. And even in the absence of a replacement for United, the deal that we've done and the costs involved are still very attractive to us. But we're very confident that we will get somebody to replace United, either from within the Group or from outside of the Group.

Andrew Barker - *International Consolidated Airlines Group SA - Head of IR*

Neil, and if we could just keep it -- we've probably got time for one or maybe two more. Thanks.

Neil Glynn - *Credit Suisse - Analyst*

Neil Glynn from Credit Suisse. If I could ask two quick ones on the transatlantic and maybe one on Vueling for Alex. With respect to the transatlantic, what is your current US point of sale, given that it's clearly increasing, and of the greater weight on the US traffic placing greater emphasis on Americans at a time where its pricing performance has been under some scrutiny and may be weakening?

The second question with respect to the transatlantic, are you seeing any evidence of carriers bottom fishing across the market, maybe accepting lower US pricing points because that looks good in euros? And does that bring any questions and any risks for the development of the market? Air France KLM touched on that to an extent.

And then the question for Vueling. Just interested in terms of how Wi-Fi is developing, having been introduced reasonably recently. Can you share any color on take up and penetration rates? Thanks.

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

Okay. We don't break out US point of sale, but obviously it is a significant part of our -- and as Enrique said, our dollar revenues. We're still short dollar. Our dollar short position next year will be about \$3.5b. It's reducing from our previous short position, given the reduction in the fuel bill, which is a big driver of our dollar cost.

But is it putting additional emphasis on American? It is to a little -- to a certain degree. But the good thing about BA, it's got a very strong brand in North America, so I think we're in a healthy position. I think American -- I don't want to sound critical of them, but I think they are underperforming in the market at the moment and I think they recognize that and I think they're taking steps to address that, which will be a positive for us.



Yes, the strong dollar does clearly influence the way people look at traffic flows. The interesting thing there is it may be that it makes some of our weaker competitors a little less weak, but it's not going to transform them. And Air France still has, I think, a short position about -- from memory, they've 25% dollar revenue, 42% dollar costs. So they can play around with it, but it's not going to change the dial in any way that would cause us concern.

And Wi-Fi, just to comment, I'll let Alex give you some details, but it's early days. Wi-Fi and connectivity is something we're looking at from a Group point of view. We are convinced that this is an essential feature, but the technology is moving at a rapid pace but is not yet at a position -- or in a position where we'd want to commit to it.

And just to give you some details, we've been looking at this yesterday. Hardware and installation cost on a long-haul aircraft current rate is about EUR1.2m, EUR1.1m/EUR1.2m per aircraft. On a short-haul aircraft, it's about EUR330,000. And so clearly, where we can fit on a line basis as we're taking delivery of new aircraft, we are. Looking at retrofit, we want to make sure that we retrofit the right equipment. And I think there is quite a significant change taking place in the industry at the moment.

So it is something that we're keeping under review. But like a lot of airlines, I think we're standing back from this just to allow what is exciting technology being developed develop to a point where we're satisfied that it's something that we can commit to in the medium term. And you'll see updates on this. We'll probably give you an update at capital markets day in November.

Alex, do you want to comment?

Alex Cruz - *International Consolidated Airlines Group SA - CEO of Vueling*

Extremely quickly. So we have no passenger data at this stage because you know we have three aircraft installed. They haven't been put into service. They're going through testing. And we are -- the regulatory agency in Spain is overwhelmed by the amount of aircraft that we're putting into the marketplace and they have to approve those first before they approve the Wi-Fi.

I will make the point, as an extension of what Willie was saying, since Vueling is not willing to pay for any of the costs related to Wi-Fi, it's going to go slow because the agreement covers the pure CapEx outlay. But we hope to get some passenger data by capital markets day. We'll see. And we hope to activate it soon. No data just yet.

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

Just for clarity, the figures I gave you are retrofit costs, just for the equipment.

Andrew Barker - *International Consolidated Airlines Group SA - Head of IR*

Okay. I think that's all we've got time for. Thank you very much.

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

Thank you.



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