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Earnings Call

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PRESENTATION

Antonio Vazquez - IAG - Chairman

Good morning, everybody. Thank you very much for coming.

Sometimes in life, the great achievements are very easy to summarize with a couple of words, or much easier with a couple of numbers, and at this point in time, to talk about the EUR2.3b operating earnings for the Company against the original initial target of EUR1.5b is a matter of pride for all of us. It has been a long way between January 2011 up to now, but I think it's what we have achieved. I've seen the great foundation when we're looking at the future, with a lot of excitement, a lot of excitement, and a lot of commitment vis-a-vis the financial community. EUR2.3b operating earnings, which is a good figure.

The other one which is very important for us because it means a lot of things, you'll recall that when we initially addressed the first communication to you at the beginning of our venture, we said that we had the vocation of paying dividends and remunerating our shareholders on a sustainable and consistent way.

So we are very glad that after the interim dividend of EUR0.10 paid in December, we are going to suggest the AGM for authorization of an additional EUR0.10, which is going to be the full dividend for the year of EUR0.20. And it is just the beginning of a consistent policy from the side of the Company which will be said at the point in time whenever we have the approval by the shareholders in June.

Just I want to congratulate Javier Sanchez-Prieto, because he has been recently appointed today. We appointed him as the Chairman and CEO of Vueling. He's taking a good legacy from Alex, who has taken a very good legacy by Keith, and it means that the Company has a succession plan on



board which is working very well. That's good news, and the other good news is we have people enough and talent enough inside the Company as we are growing up and as we are building up for what we need to build up for the future.

So thank you very much for coming. I leave you with Andrew.

Andrew Barker - IAG - Head of IR

And I think we'll go straight to Enrique for the results run through.

Enrique Dupuy - IAG - CFO

Morning, everybody. Thank you, Mr. Chairman, for the introduction.

So as Antonio was just stating, a very profitable year for IAG, our operating profit, EUR2.3b, reaching the high end of our bracket of expectations, the one that we mentioned by the beginning of November; also consistently on the higher end of the consensus of the market.

Also, of course, to mention the successful integration of Aer Lingus into the Group and the positive contribution that, even on these four months since the end of August, the company Aer Lingus has been able to bring as their value contribution to IAG, getting our reported figure to EUR2,335m, which is EUR945m better than last year and of course all of us we are recognizing that this is a very significant improvement.

And then what are the key issues, the clues behind this improvement? Of course, you'll see a lot of figures here, and revenues and costs are inflated by ForEx again this time. So it's the strength of the dollar, as you well know, basically the strength of the sterling because our UK British Airways figures are translated into euros at a strong sterling rate.

So we prefer to make this analysis on constant currency terms. And the clues are always around how our unit revenues are performing on a constant currency basis, our ex-fuel unit costs the same, and then how the fuel cost reduction has been improving our margins through the year. And these are three figures that really explain most of our performance through year 2016.

Reduction in unit revenues, because of a competitive market environment, we know about it, and our competitors lowering fares at the face of growth competition, lower fuel prices. But a very aggressive and quick response of the Group on the ex-fuel unit cost base, which has allowed us to decrease our non-fuel, our manageable unit costs, more than the reduction that we have been experiencing on the passenger revenue basis. And of course, fuel has been leveraging, catapulting this margin increase in a very substantial way.

When we get to the quarter -- fourth-quarter figures, you will see absolutely the same pattern, and this is the one that we need to follow. This is basically the guideline, the underlying medium and long term target that we are sending as a main message to our CEOs in the operating companies. We need to keep this type of performance in the short, in the medium and in the long run.

So, apart from that, a growth which has been coming down from last year, 5% on a like-for-like basis without including the figures of Aer Lingus. If we include them, of course, we get to the 8.2%. But again, it's also encouraging to see that our passengers have been growing higher than our capacities and our seats, and this has created an improvement in load factors all across the different companies of the Group.

This is the same pattern. We are risking to become a little bit boring with our presentation, because we prefer to be consistent in terms of the way we show our figures, and this is exactly the same way we show our figures for the fourth quarter. And again, we see passenger unit revenues and ex-fuel unit costs following a similar pattern.

We have to mention here, and we'll mention it again afterwards, that this figure has been adversely impacted by Paris attacks in a relatively material way. So maybe up to 1% of this reduction, around EUR45m, has to do with the consequences -- bad consequences of Paris attacks, both in the intra-European market and also in the Transatlantic market, driving passengers from the US into the Paris area.

When we get to the fuel influence, if you have the full-year figures in mind, you understand that this positive impact has been accelerating, has been accelerating in a very substantial way. We told you. We have to be very clear about it. And we will tell you again how this metric is going to be helping us through the following quarters. It's clear that this quarter we are seeing a much higher impact of the positive influence, after hedges and even after hedge -- after dollar, positive impact of fuel prices.

Growth has been very much in line with the year, basically trimming some excess capacity that we were having in some markets, but getting to the 4% to 5% above long term trend. ASKs and RPKs again are showing a positive differential that reflects in higher load factors.

So this is again how we explain the improvement in operating profit from different perspectives. It's another chart that you know. I hope you like it. We like it because it contributes -- explains things quite clearly.

We have been talking about the EUR270m of improvement in the fourth quarter against last year. It's not the right figure. If we get to the apples-to-apples comparisons and we get to constant currency and we try to eliminate the effect of Aer Lingus, the real improvement is greater, is EUR316m. So in terms of fourth quarter not being the peak in terms of growth and in terms of seasonality, this EUR316m is a very important figure.

It's also important when we compare it with some things that are happening. So, for example, if we aggregate the total fuel cost improvement in absolute terms, the aggregate of this figure is slightly below this one. So we are not only keeping in absolute terms full fuel cost savings; in absolute terms, we are keeping a little bit more.

So our growth in terms of revenues is also a net positive, and in terms of other ex-fuel costs, if you average these figures, it's neutral. So we are growing 4.3%, as you saw in the previous chart, without an increase in ex-fuel costs, which is again the same message with different words. Really, that's what we are fighting for. It's very important. And it shows we can keep fuel savings in a very substantial way, if we do things properly.

So let's expand a little bit on this ex-fuel cost management, because as you are understanding, it's a critical part of the way we manage our group of companies. Here we are. So we are talking about this minus 3.9%. I think this figure is a figure you're not going to be seeing this quarter in the results of our peers very frequently. We are proud of it.

So, of course, it has to do with employee costs, and we've been talking a lot about employee cost reduction in the Group. And we and you know it's very much related to a significant restructuring effort that the Group has been doing in Iberia and the Iberia management success in this respect; again, very significant success.

British Airways is getting flat, but it wasn't a negative underlying. And there is an issue around revaluation of service of the pension fund on a regular basis to the profit and loss account that has increased because of the lowering interest rate. So in terms of cost per employee, in terms of real manageable cost per ASK in British Airways, it's also a positive result.

And we have a minor negative in the case of Vueling that has to do with expansion and new rules that they have to follow in terms of overnights and other technicalities, but from a group perspective it's a very small figure.

In the rest of non-employee, so basically supplier and ownership costs, we have a pattern of behavior and improvements which is very much consistent with the full year one. So I asked for a chart on full-year figures to see if there were major differences with this one, and there are not. And they in some way reflect the things that we are doing through our new so-called IAG platforms. Very important and I'll try to insist on those.

Well, basically, handling, catering, landing fees, these are not so much actionable. Landing fees are about public prices. We have got a little bit of mix effect and inflation here. On a full-year basis, this is basically flat, so nothing to worry too much about.

In terms of handling and catering, it's also basically flat or low cost increases related to inflation. Here, we have also a little bit of the costs of British Airways holidays, which is not related to our ASKs; it has to do with we also buy hotels, some things like that. There is a bit of noise behind these negative figures; not very much to worry about.



This is the piece that really we are managing efficiently through the year and again through the following year. So, significant improvement in engineering costs and this is something that we are going to be following closely. There is a segment of what we call the new IAG platform which is going to be fully dedicated to re-think about our maintenance costs and our MRO structure.

And the starting -- I would say hanging fruits, low-hanging fruits are beginning to be harvested. We have been going through a very significant renegotiation of some of our engine contracts and we've been closing new contracts by the end of this year, fourth quarter. And it has been successful and it has opened a new line of thinking.

We are going to be working on these ideas into the future. And we have plans and we'll be showing you our plans, but it has had a very positive and significant improvement for Q4 and then for the full year as well.

Selling is also an improvement that we are going to be keeping. It has to do with efficient growth. It has to do also with some fee renegotiations with agencies and some improvements in our contracts, so this is healthy improvement.

IT and other. So here we are also starting to achieve the benefits of another of our IAG tools, which is GBS, the global service unit for the Group. And they'll be going to manage IT costs. They are going to manage -- they're already managing procurement costs. They will be managing financial and administration costs and back office structures for the Group. So it's another area where we are getting initial improvements that will probably get deeper and deeper into the next three or four years.

Ownership. This is very interesting because it matches very well with the messages that I was giving to you on the Capital Markets Day. We need to manage our CapEx and its consequences in terms of ownership costs on a more active way, and we told you in the Capital Markets Day we were thinking about it.

And there were a couple of ideas that we were managing and we were going to be pushing ahead, and they had to do with enlarging the operational life of some of our fleets. That's something that we have done this year with the 777 fleet. We are going to operate it about four additional years, so it brings a very important contribution in terms of reducing our ownership costs. It has to do also with the same concept with the 320 fleet.

We have done other things which have been offsetting part of that positive contribution. We have accelerated the life or the retirement dates for our 340 fleets, and that's because the substitution fleet that we have found there is a very efficient one. And we are very eager to bring these new A330s to Iberia and to Aer Lingus. So in some cases we do not the same pattern, because there are strong reasons to adapt to the different circumstances.

We are doing densification, densification of some of our fleets, for example, in the case of British Airways, and that means the cost ownership, cost per seat is improving. We are doing more operating leases and less ownership type of deals, balance sheet financings. We are renewing and extending our operating leases, lowering the rentals. All this is having a positive impact on our ownership costs.

This is fuel. So here I have very little to add to the chart, because we really undress ourselves completely here. So you have everything, starting from how the dollar unit cost is going to be coming down. But then, because of the impact of the stronger dollar, in terms of euros it will become a lower figure. Even we have the inter-plane cost variances included on that one.

So you can follow how the final euro denominated fuel unit cost for the year is going to be evolving. Very good news, because the four quarters that we have ahead of us will be showing significant cost reductions if the international fuel prices stay at this type of level. I think today was -- yesterday was \$3.45 or so.

So we are seeing a significant reduction of our fuel bill. In type of calendar terms, we could be expecting a euro figure for the full year of EUR4.8b. But you probably can manage and can model the chart with different sensitivities, because we are giving you a lot of tools to use your models efficiently and to get to the figure you prefer.

This is capacity. So this one is a little bit boring; no big, big changes in terms of capacity. We close the year on a 5-ish level. The last quarter was 4.4%. We were trimming some capacity increases and we made some tactical cancellations in the end of the year.

What we are seeing for the following quarters is very much in line, getting to a 5.3% on an apples-to-apples, on a like-for-like exercise. Of course, bringing Aer Lingus impact, it gets to a much higher figure and you see the last quarter is going to be the same, because we will have rolled over the Aer Lingus integration, getting to a 6%.

And the way the different companies are going to be contributing is the one we are showing here. So British Airways Group will be growing just 2.9%, Iberia around 6%, Vueling 14% and Aer Lingus around 9%.

This is a little bit of an anecdotic type of highlight of how this growth is going to be produced, and this is a chart that we have been showing in the past. It shows basically new routes and network changes in the first part. And it's interesting to see Iberia still recovering route destinations, as in the case of Havana, or opening new ones as Medellin and Cali.

We see British Airways getting, I would say, the growth impact of the full year Kuala Lumpur. We see Aer Lingus there opening Washington and they're getting their fuel impact. In the case of Vueling, it's going to be growth out of their basic -- bases in both Barcelona and Paris. So those are the novelties for the year.

There are also some frequency changes. I guess for Iberia it's going to be about Mexico and Canary Islands. For British Airways it's going to be basically New York and others. So, nothing extraordinary. We'll talk a little bit about Canary Islands afterwards, because it's a type of tactical strategic approach to that part of the Spanish geography.

And this is again the one that shows in the same chart our growth, this is fourth quarter again, and the results in terms of unit revenues. I think I'll start with North America and Europe. So North America and Europe have been the two areas which have been impacted by Paris, Paris weakness.

In the case of North America, we see a slightly negative growth for the quarter against last year same quarter, and that's something that we told you in advance. We were going to reduce the pattern of growth of the Group in the North Atlantic. And it has had a type of a benign result in terms of unit revenues, so this figure includes the Paris impact and probably should be lower on an underlying basis. Again, it shows a market where there is a certain stability and the performance is and is going to be a good performance for the Group.

We are seeing Europe again affected by Paris attacks and weakness. We are increasing our capacity in a very substantial way, but it has to do with what we have been calling in the past efficient growth. So three players there; on one side British Airways growing through aircraft densification, so the metal is the same, the costs attached to flights are the same and there's more seats.

So the growth that British Airways is producing here and contributing here is a very efficient one. And then we have Iberia Express and we have Vueling, our two I would say low-cost tools in the Group to produce efficient growth in the intra-European market. So what we can say is that even if this figure is a negative one, we are creating reasonable value through that 11% growth.

Domestic. Domestic has two sides, on one side Spain. And domestic Spain has been growing I would say significantly, but the growth is a stage length growth, so it has to do very much with growth in the Canary Islands and growth in the Canary Islands both produced by Vueling and especially Iberia Express.

So, again, that growth is efficient, and because of the stage length correlation with unit revenues it drags down the figure, the average figure. But we are also comfortable with the way the domestic market is performing and then in the UK it's reversing, so domestic market is starting to perform better than previous quarters, so again good news.

Asia Pacific. Asia Pacific has also a significant pattern of growth and it has to do basically with two issues; three issues, maybe. One is Kuala Lumpur. Okay, Kuala Lumpur is a starting destination and it has a negative, I would say, dragging impact on unit revenues. What we can say is that performance of the route is as expected or slightly better than expected in terms of their timing to breakeven, so good news.

The other sources of growth have to do with Japan, basically Tokyo, basically Haneda, where we are expanding our operations with good results. And also it's about Hong Kong. The full effect of a switch to A380s means unit revenues on the A380s per seat are coming down, but the costs per seat are coming down faster. So, again, this exercise is a positive one in terms of value and contribution.

Asia, Middle East -- South Asia, Africa and Middle East, here is where we have been dealing with problems in terms of fuel routes, in terms of political unrest, in terms of the tails of the Ebola. So we have been cutting capacity, and of course we have been preserving the best of the network in terms of unit revenues.

And finally, Latin America. Latin America still is growing fast and unit revenues are not performing as we would like, and Latin America has basically two stories. There is a bad story around Brazil. There has been a bad story around Argentina; it is improving. There is still a bad story that could become worse around Venezuela. That's the bad story. The good story has to do with the Caribbean. It has to do with Central America. It has to do with Mexico.

So we are working on that area. Brazil capacity is going to be reduced through the year. We are going to be trying to hold to our slots in critical airports as Sao Paulo, but we are going to be reducing the size of the aircraft, frequencies and capacity.

So, in terms of how our revenues split in the long haul networks and the short haul networks, not very more to add. So, slight decrease in unit revenues in long haul and more acute one in the short and medium haul. But again, we have to put these unit revenue reductions into context of how we are achieving this capacity growth and about the net positive result that we are getting out of our growth tactics; again, Iberia, Iberia Express here, densification and Vueling.

And this is the chart where we show the performance of our different companies in the last quarter. I don't know really what are we going to do with the next one. But it shows again improvement, improvement across the board, so very positive surprises in the case of Aer Lingus. Again, these figures are basically not constant currency, so before the currency -- stated before currency impact.

So in the case of Aer Lingus, we see an increase of nearly 3 percentage points in adjusted lease margin. And the good news in the case of Aer Lingus has been a significant improvement in their unit revenue piece, very significant, and it was something that we were counting on but not as quickly, not coming as quickly.

And the fact is that the introduction of Aer Lingus into our IAG North Atlantic strategy is becoming, I would say, very exciting. In terms of basic figures, we see cost per employee coming down by 2.5%, very impressive unit revenues, increased by 4.8%.

British Airways. British Airways getting to a 12.2% adjusted operating margin on the fourth quarter of the year. For those who are familiar with the margins and the seasonality of the business of these companies, this figure is quite exceptional. From a historical point of view, probably it could be one of the heights. So, very good performance again, improving 3.7 percentage points on last year, and also a very interesting combination between RASK and CASK.

Iberia also improving very substantially their last year adjusted margin, getting to 7%, and I'm sure more to come. Again, this absolutely impressive 10.5% reduction in employee cost per ASK, very significant. So, good figures also for Iberia.

Vueling. Vueling basically improving marginally their adjusted operating lease. Good performance in terms of unit revenues in the quarter, resilient unit revenues in the case of Vueling. Still some tailing impacts of their bargaining contract that they closed just about one -- a little bit beyond one year ago.

So as a whole, we see a very consistent improvement across the board in all our four companies in terms of operating margins, as we will see in the following page also in terms of ROIC.

This is the ROIC rolling four last quarters of the Group, 12.7%. I'll make a mention to our medium-term targets, because what we were saying in this respect here was we were aiming for a 12 plus percent ROIC for the next years, as a cruise speed type of medium and long term target.



And that was before our Capital Markets Day in November, because at our Capital Markets Day we said this figure should be getting to 15% as an average for the next period. And we are progressing very fast, quickly towards that 15% target. Last year -- last quarter, this figure was 10-point-something, so we are really getting there.

Vueling is very much on the high end of our returns on capital figures, but in the case of British Airways we are practically in the same level, and still improvements coming for Iberia and Vueling. So we are basically confident to be able to reach our 15% target in the coming years.

Below the line this year is boring, because compared with last year, last year was a bit of a roller coaster in terms of exceptionals. So here, in terms of below the line, we get net financial costs increases that are basically related to the additional financing for the Aer Lingus acquisition, basically EUR1b convertibles that we've been using. A significant part of that convertible has an accounting debt consideration, but the unit cost is 0.6% so it's very efficient funds.

There is also an increase in this other line of financial cost which is due to basically hedge accounting on hedges that are so-called ineffective ones and has no cash impact in our accounts, is going through the volatility of accounting of hedges, which you know is a little bit of a nightmare.

When we get to profit before tax, we see this significant increase before exceptional items of EUR700m. And after tax then, we get to a similar EUR700m increase. So earnings per share have been growing from the EUR0.40 to the EUR0.71 that we are showing this year, and it's significantly above the target that we had for 2015.

Balance sheet, also preserving our basic stability ratios. Remember we are talking now very consistently on adjusted net to EBITDAR, not so much on the accounting adjusted gearing metric. We are keeping this type of cash target at 20% of our revenue base.

And what this chart shows, basically, is that we have been able to go through our CapEx financings, CapEx requirement of cash, and also through the requirements of funds out of the Aer Lingus acquisition, EUR1.4b, without deteriorating our basic adjusted net to EBITDAR ratio.

And I think we are very proud of it, because in general terms, as you all know, when you acquire a company you have to pay, so you increase the capitals that you employ and you acquire their EBITDAR. But you are paying for a premium and the premium has to do with future synergies, and the synergies are not here then. So there is in general terms a dilution of this ratio that we have been able to avoid in this specific case. We are proud of it.

So, outlook. I think you have read it already; very simple. A reference to dividends, and that's something that just follows the policies that we have been explaining you that we'll be getting if general shareholder assembly approves our proposal, the proposal of the Board, by the month of June. It will be getting to a EUR0.20 per share, which will be representing something in the range of EUR407m, EUR408m, and then about 26.3, 26.4 of our earnings after tax. So, very much in line of what we messaged, very much in line with what we showed you and with the targets that we have.

The other one has to do with our trading outlook. So there again, two very significant and important messages, and I'll start by the second one. So what we are seeing in terms of revenue trends for this first quarter of the year is very much in line with the trends that we have been showing, the underlying trends of what we have been showing. Nothing special; nothing traumatic. We are not seeing any special weakness coming because of the market turmoil at this moment in time.

So at this moment in time, we are feeling absolutely confident about reaching to our targets, the targets that are embedded in our forecasts and our financial plan; confident. And that's why we are saying that we will be expecting an absolute operating profit increase similar to the one that we have achieved in year 2015.

Good. So that's basically --



Willie Walsh - IAG - CEO

Thank you. Just before we take your questions, to add to the comments of the Chairman, I'm delighted to see Javier is here today. He will be known to most if not all of you as the CFO of Iberia. So I'm delighted to appoint him to the CEO of Vueling. He's got a fantastic track record in terms of financial and operational transformation, financial cost control. I think the work that he's done with Luis at Iberia is a great reason to transfer him now to Vueling; great leadership style.

He's in the room here, so he knows I'm praising him and setting him up for the next 12 months of performance, when he'll stand here in front of you to tell you exactly how well he's done. But it's a great appointment. And as the Chairman said, I think we're fortunate in terms of the Group structure to have great talent within the Group that we can manage succession plans.

Luis, Enrique and I have discussed about Javier's replacement in Iberia. We'll announce that within the next week. It will be an internal appointment. And that's something that Luis will announce within Iberia probably by the end of next week or early the following week.

So thank you, Javier. You can start sitting up at the front of the room now to answer questions as well.

So there is, by the way, a very interesting appendix in the presentation and it's there for your benefit, not for ours. So it's there to assist you, but I'm sure Andrew and the team will have taken you through it.

So it's over to you for questions and Andrew will manage this.

QUESTIONS AND ANSWERS

Andrew Barker - IAG - Head of IR

I think Damian got his hand up first.

Damian Brewer - RBC Capital Markets - Analyst

Damian Brewer, RBC. Can I ask two questions, please? First of all, in the Q4 numbers and looking into 2016, how much progress was already made in terms of Aer Lingus on either revenue and cost synergies? And could you elaborate a little bit more on what impact that had on the numbers?

And then secondly, I guess the best way to characterize it is the future uncertainties become more uncertain. When you're thinking about planning 2016 and into 2017, how do you think about the flexibility in the business and how you'll capitalize on that, given that events look pretty unpredictable at the moment?

Willie Walsh - IAG - CEO

Just a brief comment on Aer Lingus' early performance. It's very encouraging. It's probably ahead, to be fair, of where we thought it would be. The outlook for 2016 is better than we thought it would be and I think the opportunities that we believed existed with Aer Lingus as part of IAG are very clear. And in fact, to his credit, Stephen believes there's further opportunities there.

So the Aer Lingus performance in 2016 that we've baked into the plan, I would expect us to exceed that, but that's clearly the challenge that we've set for Stephen. But the performance in 2015 and going into 2016 is very encouraging, particularly the transatlantic, but also what they've been able to do managing their competitive position versus Ryanair in their home market, which is clearly a significant challenge.

In terms of flexibility, it's been the key to the creation of IAG. From the very beginning, we said that we needed to ensure that we had more flexibility in the business than airlines have traditionally had. And a number of the measures we've taken since we've created IAG are designed to reinforce



and enhance that flexibility, common procurement, common specification, to give us flexibility to move assets across the operating entities so that we can take advantage of opportunities or better utilize capacity than an individual airline would have been able to do.

So we're all the time looking to bake in more and more flexibility into the business, both from a financial point of view and an operating point of view, and that will continue to be our focus. So, as Enrique has said, we've got a really clear focus this year on aircraft ownership costs and aircraft maintenance costs, and that's all designed to have even further flexibility within the Group going forward.

2015 was -- I would say it was a challenging environment for us, particularly given the volatile nature of currency and fuel, and there were plenty of challenges in the macroeconomic environment as well. I think we came through 2015 with a very strong performance, and that's our view about 2016 as well. As Enrique said, the outlook for the first quarter is at this stage slightly ahead of our original plan, and that's encouraging.

We see capacity being broadly in line with what we had expected for 2016. If anything, we think the third-quarter capacity environment should be positive. So it's a bit early to take a call on the fourth quarter. That will be, as we all know in Europe, heavily influenced by Ryanair and how many aircraft they decide to ground, and we've taken a view on that as well.

But I think looking at the first quarter, we're comfortable and confident. Second quarter, the outlook is in line with our expectation. Third quarter, we believe there's opportunity. And fourth quarter, we'll look at the fourth quarter as we go through the year.

So I don't know, Enrique, do you want to comment further on flexibility?

Enrique Dupuy - IAG - CFO

Well, in terms of flexibility, we have in every one of the operating companies our own plans, our own levers to use. In the case of Iberia, it's a high growth pattern which is balanced by a high level of flexibility embedded in our operating leases. In the case of British Airways, it's having the buffer of highly depreciated 747 and 777 fleets that we could easily ground if we needed with a positive benefit, if it was the case, in terms of the balance between revenues and costs that we could be saving.

In the case of Vueling, it's I guess the sublimation of flexibility. Because of the number of aircraft that they have on a lease basis that we renew or we extend on a year-by-year basis, the flexibility to adapt to a turning of the cycle in the case of Vueling is very, very rapid. And in the case of Aer Lingus, it's also having a very flexible fleet structure that we could basically drive in the right direction very quickly.

So we are very happy with the growth patterns that we have been showing you, because they represent the way we can optimize the use of our assets and the use of our capital. But at the other place of the balance, we are always thinking about the what-ifs and how to adjust to a different environment, and that's something that all the CEOs and the management committee in IAG are absolutely aware of every week.

Andrew Barker - IAG - Head of IR

Go to James.

James Hollins - Nomura International - Analyst

Thanks. It's James Hollins from Nomura. Three questions, please. The first one's on London City Airport. You've made some pretty interesting threats to leave there. I was wondering if you could give a bit of discussion about what sort of returns you make, obviously not a figure but just whether it's what the sort of airport you'd like to stay at and whether you would carry out your threat.

The second one is on employee unit costs. Clearly Iberia very impressive; BA was relatively flat. As we look into full year 2016, do you think there's much more we can do on Iberia and also on British Airways? Would you expect that to improve a lot this year and would be disappointed if you hadn't?



And then the final one, obvious question alert, just some thoughts around what you would see operationally, maybe financially, on Brexit? Thank you.

Willie Walsh - IAG - CEO

Okay. On London City, it's a good airport. Our performance is encouraging there from a financial point of view. The Embraer fleet that we have works well. So, Cityflyer as an operating unit within the BA network is performing well for us.

What we've said about the airport is when we looked at the purchase price, and I'm not clear what the actual purchase price was, that our assessment of that was that the new owners, to make a return, would need to increase charges. If they do increase charges, which average if you look at their figures around GBP20 per passenger, well then, yes, we will carry out our threat and reduce our capacity.

City Airport is doing well for us but it's done well because of the growth of British Airways, and what we're telling the owners is that they shouldn't take that for granted. We will grow there if it makes sense. We will grow there if it's profitable. If the routes at London City are not profitable, then we're going to withdraw.

And we have the flexibility to -- as we've demonstrated, so we're going to start flying some of those Embraer aircraft at Stanstead during periods where City Airport is closed. We have flexibility in terms of the size of the fleet, because we can reduce the number of aircraft in the fleet. So we do have quite a bit of flexibility with our London City operation.

We want to continue with a presence there, but we'll only continue there if it's profitable for us. And we're not going to be in a position where a new owner thinks they can just jack up the prices and we'll continue to do what we've done historically. We felt it was important that we said that before the transaction was complete, rather than wait for it to be completed and then pass that message on.

The sellers have told us that the new owners are very decent people and don't really want to make a huge return. They would say that, I suppose, but we'll see what the new owners have to say. But I've laid out our position very clearly for them. If they want us to continue to operate at City and continue to grow our presence, then they need to be realistic in terms of the charges.

Enrique Dupuy - IAG - CFO

In terms of employee costs, yes, there's more to do in every one of the companies of the Group. Iberia is thinking about frames, legal representative frames to use on their next big exercise, and that's something that will be coming through in the next couple of years. The same in the case of British Airways.

We are already using the new tools of the Group, the new platforms to produce some of these lift and shift type of exercises, and they have to do, basically, with areas as IT, very significantly. There's going to be a significant reduction in IT employees, all across the Group, and this includes all the four companies. The same with finance and administration. Our procurement teams have already concentrated in Krakow, with just a very minimum presence in London.

So, yes, there's more to come and we are every day thinking about ways to increase our productivity and produce better employee costs per ASKs. And it's going to be coming. On some cases it's already well defined. In others, it's an exercise that we'll have to finalize and fine tune through 2016 and 2017. It's critical in our five-year plan.

Willie Walsh - IAG - CEO

In terms of Brexit, as a company we're not taking a position, so we're not going to try and tell people how they should vote. We have undertaken an assessment of what a vote to leave might mean for our business. And while it's clear that there would be uncertainty, there is uncertainty, and



that uncertainty would continue for a period while negotiations between the UK and the EU take place, our assessment is that from a regulatory point of view there would be no impact. So our traffic rights we don't see being impacted at all.

And from a business point of view, our assessment at this stage is that we don't see a material impact on our business. But that doesn't -- let me be very clear. We're not saying yes or no to the referendum. I think that's for the electorate to decide. I've expressed a personal view, but we're not expressing any business view. But as I said, we have undertaken a risk assessment as to whether a vote to leave might be --

Andrew Barker - IAG - Head of IR

Go to the second row. Jarrod.

Jarrod Castle - UBS - Analyst

Morning. It's Jarrod Castle from UBS. Three, if I may. In November, you spoke about to hit your targets you needed to keep 15% to 20% of the fuel tailwind. So just in terms of the 2016 targets, is that kind of what you're factoring in or you're factoring in a bit more?

Secondly, just on CapEx, you spoke about extending life of fleet, and I think on average you wanted to spend about EUR2.5b on CapEx. Can we maybe start to expect a bit less?

And then thirdly, just a quick one on the BA pension and the actuarial review, etc., if there's any update. Thanks.

Enrique Dupuy - IAG - CFO

Yes. Pension funds, you know it's a triannual exercise; nothing to add this time. It takes time, it's long, it's painful, and it will be finishing by the end of June, we guess. We don't foresee anything special coming from these renewals, but we need to fight the bull here. Okay?

Willie Walsh - IAG - CEO

That's a Spanish term.

Enrique Dupuy - IAG - CFO

Yes. So at this stage, nothing to add. It's business as usual. In this case, it's a type of typical business to deal with, but nothing special.

And the other two, sorry, there was --

Willie Walsh - IAG - CEO

CapEx. As we've said, our view there is we have scope to adjust plans in relation to fleet, whether we purchase aircraft or lease aircraft. We're very clear that there is significant opportunity at the current time to lease aircraft, particularly good quality secondhand 777s in particular, 777-300ER or something that -- since we expressed an interest in potentially leasing secondhand 777s and A380s, we've had some very attractive and detailed offers being made to us in relation to that. So that will help us to offset some of the strength of the dollar. So we expect our CapEx plans in 2016 to be within or below the previous guidance that we've given.



Enrique Dupuy - IAG - CFO

And the numbers that we've made in terms of buy or lease, and we have been discussing that one with Andrew just a couple of days before, are really encouraging in terms of the lease approach. Really, getting into a buy decision, it's not so attractive in terms of ROIC, especially if we compare the ROICs that that activity would be producing with the ones that we require to ourselves. So we are biasing gradually more and more our decision towards the lease.

So maybe this is a futuristic approach, but we in some way think that in the future ownership of the aircraft, not the buying of the aircraft, the ownership of the aircraft is going to be more and more of a commodity and of a service that third parties are going to be providing to the airline groups.

Willie Walsh - IAG - CEO

The first question, sorry, I missed the beginning of your first question.

Jarrold Castle - UBS - Analyst

Yes. Just from November you're talking about 15% to 20% of the fuel tailwind to keep it and to hit your 2016, 2020 targets. I'm just wondering if that's the minimum you're factoring into the current year forecast.

Willie Walsh - IAG - CEO

Yes, at Capital Markets Day what we said was we were only baking in 15% to 20%. That's not what we were aiming to do. Clearly, we're aiming to do better than that. So nothing has changed from what we said at Capital Markets Day.

Oliver Sleath - Barclays Capital - Analyst

Hi. It's Oliver Sleath from Barclays. Three questions, please. Firstly, about the dividend and cash flow, I think your guidance implies that you could generate quite an excess of cash above what you need to pay your ordinary dividend this year. I just wondered, if you didn't find much M&A opportunity, would you be -- could we see some of that cash coming back to shareholders in the form of a special dividend? Is it a bit early to say there? Do you need some more clarity on the pension, things like that?

Willie Walsh - IAG - CEO

I think it's too early to say. We have had this discussion with the Board. We're pleased to have introduced the dividend payment. We're delivering on what we said. And if at a future date we had excess cash available to us, clearly we would consult with our shareholders as to what they would like us to do with that. But at this stage, that's something for the future; it's not for today.

Enrique Dupuy - IAG - CFO

What we are planning as the basic frame, and it's curious because we're matching the figures, is we were able to produce a sustainable growth pattern from the financial point of view, distributing 25% of the distributable after-tax earnings. And that would also be framed by being -- representing about one-third of our free cash flow. You see the figures this year, bang matching the two ratios. 26.2% and our free cash flow is around EUR1.2b, so EUR401.2m is just a third. So we feel very comfortable with the stability of how we have started our dividend policy. If it proves too stable, we'll give it a second thought.

Oliver Sleath - *Barclays Capital - Analyst*

Thanks. And just two interesting questions, if I may. Firstly, are you seeing any change at all in Gulf carrier behavior, given pressure in the oil markets, in terms of their capacity plans or their pricing behavior?

And the second question, just about general industry capacity, it does feel like there's quite a divergence in airline financial performance between Europe and the US at the moment and some of the emerging markets like Latin America, where things are obviously a lot tougher. I just wondered if you'd expect or you're seeing any shift in capacity from some of these weaker emerging market regions into places like Europe and the US, either in the order book or in the current fleet, and whether that's an opportunity for you or perhaps a threat to capacity discipline in Europe. Thanks.

Willie Walsh - *IAG - CEO*

We haven't seen any evidence of that to date. It's always something that we are monitoring. In fact, the outlook that we have in terms of capacity on the North Atlantic is very encouraging at the moment. We've seen Delta Virgin plan to reduce some capacity, principally on the back of gauge of aircraft. There is some capacity coming in from Canada. Both Air Canada and WestJet are increasing capacity.

But in the main, our view on UK transatlantic capacity, it's pretty good. And any increase in capacity we think is certainly justified by the growth in demand in that market. There's probably a little bit more growth going in from Europe to the US, where we have some limited exposure, principally through our joint business partner, American Airlines.

But in the main, having looked at the known plans for 2016, which we think will be moderated, we think the general capacity environment continues to be quite good for the industry, with little or no evidence of people changing behavior on the back of the lower oil price. Certainly, at this stage we're not seeing any evidence of a change in behavior. What we're seeing is what we had expected to see and in some cases is better than what we had expected to see.

And sorry, the first one you asked was?

Oliver Sleath - *Barclays Capital - Analyst*

Gulf carriers, any change in their behavior.

Willie Walsh - *IAG - CEO*

No. I think you'll have to separate out the three at this stage, because clearly Emirates doesn't have an oil economy, Qatar has a gas economy and Abu Dhabi oil and gas. So it may have some impact in the medium to long term. I don't see it impacting on any of Qatar Airways' plans. We haven't seen any evidence of it impacting on Emirates' plans.

And I think Etihad's exposure goes beyond what they're doing themselves, because of their participation in airlines across Europe, Alitalia and Air Berlin in particular. And certainly the uncertainty around Etihad's code sharing rights with Air Berlin is probably something that may influence their issues there. As you know, the German government removed approval for code sharing, which was reinstated following a court case, but I believe that that's only until the end of March. So I don't think that issue is fully resolved.

So there are some issues there that probably have a greater impact on Etihad's plans than on the other two. But at this stage, we haven't seen any change in behavior or any expected capacity changes as a result of the lower oil price.

Andrew Barker - *IAG - Head of IR*

Go to Edward.



Edward Stanford - *The Lazarus Partnership* - Analyst

Good morning. Edward Stanford from Lazarus. Just picking up on a point you made earlier in the questions about thinking about ownership of aircraft in the very medium and long term, and you seem to be reviving the concept, perhaps, of a virtual airline which was around a few years ago. To what extent, logically, do you think that is feasible? Does IAG always need to actually own some aircraft? Perhaps you could expand on that thinking a little bit in terms of the way you see things now.

And secondly, you've made great progress with maintenance contracts. Are you able to elaborate in terms of the sort of savings you've been able to achieve and where else you see big opportunities in the near term? Thank you.

Enrique Dupuy - *IAG* - CFO

Yes. In terms of the ownership structure of our fleet, of course our ideas and our developments are very much framed into the group of company type of concept. Of course, if you have one single company and you make it virtual, what else? So, no, we have a group of companies and we have understood that some of our fleets, and then more and more probably, should be considered as group fleets.

For example, the A320 fleet, we are going to have more than 300 aircraft. It should be considered as a group fleet. Maybe the A350s and the A330s, again, group fleets. And we understand those fleets should be played on a flexible and efficient and type of fungible way through our different companies, because that should be bringing a lot of opportunities in terms of the better use of our asset base.

And then a contributor to that exercise would be probably to have them under singular group financial type of tools behind, and some of these financial tools probably will be taking the shape of operating leases. Because the operating lease concept brings flexibility, which again is a very preferred and favorite concept on our structure.

And also, as we were saying, the advantage of buying -- you see, the last numbers that we were making about buying or renting, buying has a return on equity or a return on invested capital in the range of 9%. We want more for our money. Maybe 9% is good for a lessor, because they have a stable financial model with a stable asset behind that they know how to play with. Okay, 9% for them. For us, 15%.

So we need to use our equity in a very selective and efficient way. So we will develop ideas to bring all these fleets into single ownership structures and to bring operating lessors and other type of investors and partners as a way to release funds that we need for other major purposes, as paying more to our shareholders.

Willie Walsh - *IAG* - CEO

On the maintenance side, there's still a lot of work to do. I think we're encouraged by some of the renegotiations that have taken place. But the real focus now is on internal maintenance activities, the assets that we have within the Group, the activities we have across the four airlines, the different maintenance models that we've had. And in the same way as we've said common specification and common procurement, the same applies with maintenance as to the physical assets, if you like.

So there's a lot of activity going on at the moment. It's clear that we have certain maintenance activities that probably do make sense within the Group and other activities that would be best supported or supplied by a third party supplier.

And looking also at any investments that we would need to secure maintenance facilities for the future, we're clearly looking at, as Enrique said, that in the very same way as everything else, what is the return on the capital that we would need to invest? And if we're not going to make an adequate return on that, well then can we do it in a more efficient manner?

So everything is up for review at the moment. The focus to date has been on renegotiating contracts with existing suppliers or changing contracts to new suppliers, and we've seen benefit from that.

Enrique Dupuy - IAG - CFO

That's just the tip of the iceberg.

Willie Walsh - IAG - CEO

Yes, but there's a lot more to do.

Andrew Barker - IAG - Head of IR

Neil.

Neil Glynn - Credit Suisse - Analyst

Neil Glynn from Credit Suisse. Two, if I could. The first one on cash flow, on working capital in particular. There was a very large outflow in 2015 of about EUR600m. Just interested in terms of what actually moved there and how we should expect the next quarters to develop accordingly.

Enrique Dupuy - IAG - CFO

Three things, by thirds, approximately. First is bringing in the working capital requirements of Aer Lingus on their low season, high working capital requirements. So that's number one.

Number two is mathematical. So, one of the elements of the net working capital requirement has to do with, as you know, the payables. A big chunk of our payables are fuel, and the fuel prices after hedging have been coming down by 20%, so suddenly our payables have been reduced by 20%. And those were funds that we were including in the working capital type of net balance, so they have disappeared. So it's mathematical.

And the third one is prepayments. Part of the contracts that we have been renegotiating have required prepayments, and that's something that we have volunteered to. Because the use of cash at 0.5% return, probably, the alternative one on a dealing of a contract which requires prepayments is much better.

So, three sources, totaling something in the range of EUR600m.

Neil Glynn - Credit Suisse - Analyst

Thank you. And the second one, on Iberia, obviously there was the recent announcement of new Asian routes, Tokyo and Shanghai. Just interested in terms of how you expect traffic flows to develop there, as to whether you expect more Spain or even LatAm originating traffic or whether it's the other end of the route.

Willie Walsh - IAG - CEO

Yes. Luis is here. If we have a microphone?

Luis Gallego Martin - IAG - CEO, Iberia

Hello. Good morning. We will have started October 18 flying to Tokyo. We are still pending of the slots and traffic rights to Shanghai. But the evaluation that we have done, we have enough demand from Europe and Spain to start the flights. It's true that we are going to have also flows coming from LatAm, but at the beginning we have been conservative in the analysis. We are sure that we are going to have more demand coming from them.

But with the numbers we have done, we are pretty sure that the route is going to do very well. So that's the reason we have announced now, because the cost structure that we have now allows us to start an operation that was impossible before.

Andrew Barker - IAG - Head of IR

To Andrew.

Andrew Lobbenberg - HSBC - Analyst

Hi. It's Andrew from HSBC. Can I ask a couple on regulation? Enrique, you said that Aer Lingus was going well coming into the family on the North Atlantic, but where is it in the process of formally coming into the JBA in terms of regulatory approvals?

And then, with regard to the same joint venture thing, LATAM, where are we going with that approval process and how able is the company to engage, given the challenges they are going through?

And then the third, if I dare be greedy, could we have a little bit of chat about where Vueling is going with the network at the moment? Quite a lot of stuff coming into the UK. How much is that reliant on a BA code being slapped on those flights? And equally, is there any plan to reciprocate and put the Vueling code across the BA short haul out of Gatwick, for example?

Willie Walsh - IAG - CEO

On the first issue, Aer Lingus joining the joint business, that's the subject of in the first place negotiations between the joint business partners. So we have to agree the base year to bring Aer Lingus in, the capacity plan. So that negotiation is ongoing and we would expect that to conclude in the next few months. The regulatory process in terms of approvals to bring Aer Lingus into an immunised joint venture, that's in place as well. So there's work in progress there which we would expect to complete in a couple to a few months.

On LATAM, LATAM are fully engaged with the regulators on the joint business proposal. No comments to make there. That process will go on for some period of time yet, probably 12, maybe even 18 months. So it's far too early to make any comment in relation to that.

And on the Vueling network, well, we'll give the first part of the answer to Alex and then I'll watch Javier's reaction as Alex sets him up here.

Javier Sanchez-Prieto - IAG - CEO Designate, Vueling

Yes, taking notes.

Alex Cruz - IAG - CEO, Vueling

So, if Javier will let me make some comments. So, for starters, the code share agreement with BA is fully reciprocated. So both airlines are selling both airlines, each other. That's fully -- (inaudible) of Vueling is selling BA flights in Vueling sales channels. So from that perspective, there is a full agreement and it's working as any other code share agreement between two airlines.



Vueling's network continues to develop. As we have been explaining over the years, there is a big focus on Barcelona, continues to be. The growth rates become smaller as it becomes really, really big. Rome has gone beyond the startup phase and is now on a build-up phase. We have rationalized the network and we're very happy with the domestic performance, which used to be an issue a while ago; no longer an issue.

And Paris, which has always been the second largest metropolitan area served by Vueling, continues to be an area of focus. The only change in the last year has been to expand beyond Orly, because it's been really, really difficult to be able to have access to additional capacity in Orly. So we finally decided to move on to Charles de Gaulle and for now look at opportunities there.

Those are the three axes of growth. No change, but I'm sure that Javier will tell you if he'll deviate from that in the future. But for the moment, that's where we are.

Andrew Barker - IAG - Head of IR

I've got time for one more quick question, as long as it's an easy one. Go to Andrew.

Andrew Light - Citi - Analyst

Yes. Andrew Light from Citi. Just two. First of all, how confident are you about the ability of premium traffic and business traffic to keep pace with the capacity growth plans of BA, Iberia and Aer Lingus? I'm not too bothered about Vueling, particularly as we seem to be in about the eighth year of an upcycle in premium traffic and given macro problems affecting several sectors.

And then secondly, on aircraft, the lessors keep saying that there's an undiminished appetite for future generation aircraft, despite low oil prices. I'm just wondering if you agree with that and whether there was a difference between long haul and short haul.

Willie Walsh - IAG - CEO

Certainly, on premium, premium performance in 2015 was better than we had expected. So we're very encouraged by the premium performance in both Iberia and Aer Lingus, who are seeing very significant demand for premium products. I think that reflects the quality of the product in both of those airlines now. So that's encouraging. BA is in a more stable environment but, as you've seen, the decision to reconfigure a number of the 747s into the super high J configuration reflects our view that the growth in premium on certain key markets will continue and that appears to be the case so far.

So it's something we keep under review, but we do have flexibility to adjust our premium capacity. If anything, I would say there's probably a case for Aer Lingus -- Stephen is here. He could comment on it, if you want. Increase some premium capacity, given the demand that we've seen so far. Iberia's premium demand has been very encouraging and I think --

Enrique Dupuy - IAG - CFO

Think it should be growing 2.9%, so we are comfortable.

Willie Walsh - IAG - CEO

Stephen, do you want to comment on Aer Lingus?



Stephen Kavanagh - IAG - CEO, Aer Lingus

Yes. We've seen premium grow by 25% in 2015. That's from a relatively low base. Our aircraft are configured approximately 10% of seating is premium. We see an opportunity to push that. We've invested in product. We're seeing that rewarded with patronage and price. So we think we can push that a little, but it's a small relative increase but very relevant in terms of our topline and increasingly our ROIC.

Willie Walsh - IAG - CEO

And on the leasing situation, there appears to be continued good demand for the new generation aircraft. There are technical issues, clearly, with the A320neo aircraft which has come into service, but the engine issues are still not fully resolved. We've not yet made an engine choice. I'm pleased, actually, we have an opportunity to look at what's happening there. That may discourage people in the short term, but I don't see it discouraging people in the longer term. And on the wide-body side, we haven't seen any change in behavior at this stage.

So fuel is nice at \$34, whatever it is, \$33, \$34 a barrel. I don't know what it's going to be in 10 years' time. But our fleet decisions are 25 and increasingly 30 year decisions, and fuel will be a feature of the business for that period. So anything that will improve our fuel performance and our environmental performance, and that's a critical part of it.

We're coming up to the ICAO Assembly in September, October of this year, which will be I think a very important milestone for the industry in terms of the industry's environmental credentials. So we've got to continue to focus not just on our fuel and financial performance, but also the environmental performance. And I think the evidence suggests that that is still the case right across the industry.

Enrique Dupuy - IAG - CFO

The big majors will be taking the deliveries on new generation aircraft, especially the long haul, so that means that a significant stake of not so old efficient aircraft will be coming to the market on leasing basis. And at these prices for fuel, they will be becoming a very interesting choice.

Willie Walsh - IAG - CEO

Okay. Well, thank you very much.

I think we're delighted for two reasons. One, I think the financial performance was very strong, and particularly when we go back and think of what we said to you in 2011, when we said we were going to target a EUR1.5b operating profit and a lot of you laughed at us. So, EUR2.3b plus was a nice end result.

And secondly, we've started paying a dividend, and that's something that has been very important to us and I know very important to you and our investors. So I think a great achievement in 2015 and a lot more to do in 2016.

This is Keith's final appearance at an IAG presentation as a member of IAG. He will probably turn up at AGMs as a shareholder, and he assures me he will be generous and kind in his comments about the performance of the business as a shareholder. But can I just acknowledge the fantastic contribution that Keith has made to the business? He's still working for us and will continue to give it everything he has until his final day in the office, but this is the last opportunity for me to say that in front of you as an audience. So, Keith, thank you very much for everything you've done. And thank you for attending.

Operator

Thank you. That will conclude today's conference call. Ladies and gentlemen, thank you for your participation. You may now disconnect.



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