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IAG.L - Q1 2016 International Consolidated Airlines Group SA Earnings Call

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PRESENTATION

Operator

Good day and welcome to the IAG Q1 2016 earnings presentation conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Willie Walsh. Please go ahead, sir.

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

Thank you and good morning, everyone. Thank you for joining us on the call. As usual, I will hand over to Enrique Dupuy to take you through the presentation on our Q1 results.

Enrique.

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

Thank you, Willie. Good morning, everybody.

So we are presenting today a strong set of results for the first quarter of year 2016. As you know, the first quarter is probably one of the weakest quarters for the year, so these results we are bringing in today have, I would say, a special positive significance.

Talking about our operating profit, we've been reporting pre-exceptional items EUR155 million. These represent on a pre-Air Lingus, pre-exceptional basis, EUR181 million. It represents also a reported improvement of EUR130 million, although as you will see further on, the real like-for-like improvement is above EUR200 million.

These results have been produced on a capacity increase, which is on a reported level close to 12%, 11.9%. If we do the pre-Air Lingus adjustment, we get to an underlying, non-Air Lingus companies of the Group, capacity increase of 4.8%, which is very much in line with our expectations.

In terms of demand, the increase has been 13.8%, which basically will be showing an improvement in our load factor levels for a quarter of 1.2 percentage points.

Talking about now -- talking about unit revenues and unit costs. On the revenue side, we see a reported unit revenue performance of minus 3.6%. There is currency benefits out of the strong dollar, so we make that correction. And we also correct about the contribution of Air Lingus which has a different stage length from the average of the Group; we'll be getting to a unit revenue, like-for-like comparison with last year, of minus 4.9%.

Getting to the unit cost, the reported figure is minus 6.1%, of course, affected again in the same way by the dollar strength. And making the same type of corrections and including, of course, the positive impact of fuel prices after hedges, we will be getting to a reduction of minus 9.3% against last year; so basically, doubling the reduction in unit revenues.

When we get on the passenger unit revenue figures, what we see is a reported figure of minus 3.5%, which again, correcting by ForEx and Air Lingus participation, will be getting us to a minus 5.2%. We'll be talking about these figures later on in the presentation.

On the ex-fuel unit cost arena, we are reporting an increase of 1.3%; of course, again, ForEx included and Air Lingus included. Stripping or cutting out those two effects, we get to an underlying improvement of 0.5%.

So let's go a little bit through the operating profit bridge and the picture, how it shows. Here is basically where we explain how we'll be getting out of the reported change of EUR130 million through a ForEx negative impact of EUR60 million and also a first-quarter negative impact of Air Lingus of EUR26 million. You know Air Lingus is seasonal so this figure is normal on the first quarter of a year; better than last year, as we will explain you afterwards.

So after these two adjustments that you see on the right-hand side of the chart, we get to a Q1 net like-for-like improvement of EUR216 million. If we compare that improvement with last year, which was EUR180 million, around EUR180 million, you see we are getting a similar level of improvement as we were getting on the first quarter of last year.

When we have a closer look to the whys and the hows of this improvement, we see that in terms of capacity movements, there is a balance situation. Of course, last year, the operating profit was just EUR26 million, so there is a balance situation in terms of capacity.

Big movements have to do with unit prices and unit costs. The more relevant of them all, of course, is the unit cost reduction, after hedges and in constant currency terms, of the fuel bill which is worth more than EUR430 million.

On the other side of the balance, of course, we have a unit revenue reduction in constant currency terms which would be worth about EUR224 million, so about 50% of the fuel cost improvement that we have been achieving through the quarter.

It's also significant to mention, and I will go a little bit more in detail on further slides, the employee improvement, which is basically having to do with productivity improvements as I will tell you, and across the four companies of the Group.

So maybe then coming into the cost slide, slide number 5, again, we tried to build up, as I told you previously, the way we can get to the minus 0.5% out of the reported plus 1.3%. And it has to do with, again, a negative ForEx impact that is about 0.7 percentage points, and also about Aer Lingus' negative impact of 1.1 percentage points.

Just for the purpose of understanding Aer Lingus' negative impact on the cost side, of course, they are a very lean, efficient and effective company in terms of cost, but because of the shorter stage length, shorter than the average, they are bringing this averaging negative impact into the rest of the Group.

Having said that, we go through the cost chart and we recognize there the significant improvement that we are bringing, again, on the employee cost side. A big figure to retain there is improvement in productivity for the Group has been reaching 5.9% in the first quarter, and unit cost reduction in terms of employee cost is in the range of plus more than 3% reduction. So good news on that front.

On the supplier side, we have benefits coming from stage length increase, both in handling/catering landing fees. We have a negative landing fee increase in terms of fees, in terms of price, and that's a combination of a positive performance last year and a negative this one.

The negative has basically to do with overflying fees on the air space of Russia which, as you know, for us is very significant on our Far East routes. Also up to some extent, landing fee increases in Japan. So this is a one-off one-quarter effect that will be getting diluted through the remainder of the year.

A little bit of increase is also in engineering. It has to do also in the case of Vueling with a little bit of base effect. And in the case of Iberia, it has to do also with increased works for third parties which, of course, we get the revenue contribution at the other side of the line.

In terms of selling costs, also good news. Our selling costs are remaining quite freezed, quite stagnant on the increase of capacity performance, so that's why we are getting this unit cost improvement on the selling side.

Ownership has to do, of course, with how we are trending in terms of new fleet financing, and as you know, because we've been telling you before, we are trending towards more sale and operating leaseback solutions, and that will be increasing our operating lease percentage in the ownership cost and probably decreasing the depreciation element.

So as you see, it has to do with this impact; and, of course, with the global impact of the improvement of the average age of our fleet and the deliveries of new-generation aircraft.

So coming to page number 6 where we have this chart, the same as previous quarters, where we can explain the movements, the main movements in the fuel bill. We are basically showing a very consistent chart with previous ones.

For the quarter that we are facing now, Q2, we'll be getting dollar-denominated after hedging fuel decreases of 20%, and as you see, the dollar element in that equation is not going to be changing this time very much. The final reduction will be slightly above 30%.

And that pattern of reduction you will be -- see them again through Q3 and Q4, and again entering into next year with percentages of decreases which are close to the 20% level.

The scenario, the exercise, the example that we'll be making this time on the final fuel bill due to this movement in -- after hedging fuel cost and dollar, will be concluding on a final figure in the range of EUR4.8 billion, and after having moved slightly, both the price of the underlying fuel market price and also of the dollar/euro rate.

So basically, a similar pattern as we saw in previous quarters, and more information, good information, and good prospects about the year 2017.

So we are moving now to page number 8 where we are reflecting movements in capacity for the next quarter, which is Q2, and what we expect will be the full-year figures for year 2016. So as you see, Q2 will be reflecting a lower level of growth, especially for the non-Aer Lingus integrated group of companies, and that's getting to 3.7%.

We have to remind you that Q2 last year was a little bit of a peak in capacity growth through the year, so the comparable in this case with Q1 this year is in some way easier in terms of capacity increase, just reaching the referenced 3.7%.

For the full year, we are expecting to reach 4.9%, again on an IAG pro-forma basis, so taking into account both in the base and in this year the impact of Aer Lingus. This figure on our, I would say previous exercise, was 5.2%/5.3%, so that's the level of capacity adjustments that we are now foreseeing to be implemented quickly through the next couple of quarters.

The split by companies, as you see, in Q2 will leave both British Airways and Iberia broadly in the range of 2%, and having Vueling in the range of 14%, Aer Lingus at the level of 7.7%.

Full-year figures are not very far away from these ones. You see again British Airways 2.6%; Iberia slightly above 4%, 4.4%; Vueling around 15%; Aer Lingus around 11%.

Moving to the basic causals and moves in capacity on the different networks, on the different companies -- so this is page 9 -- what we are seeing is basically network changes on the different carriers.

For Iberia, it's going to be about -- and we are referring to Q2 still -- it's going to be about the impact of Havana; we told you about it, Cali and Medellin.

For British Airways is about Kuala Lumpur. Of course, we've been talking about Kuala Lumpur for a while now. It's about San Jose in California; it's about Lima and the new service from Gatwick to JFK airport.

In the case of Aer Lingus, it's basically driven by the new route to Los Angeles. And for Vueling, its most of the growth out of Barcelona into new destinations.

So you see in this case, Q2 will be showing a higher proportion of new destinations and network changes into our basket of capacity movements. That's something slightly above what we have seen in previous quarters, and it's showing a little bit of a higher level of what we will be calling investment into new routes.

The rest of the moves, basically, there was -- we attribute to frequency changes, aircraft gauge improvements, etc. Have probably lesser level of significance.

So this is going to be Q2, and through Q2/Q3 we'll be implementing some of these adjustments in capacity that we've been telling you about, and that basically will be rendering the adjustment benefits through Q3, especially Q4, so the end of the year.

So maybe now we can move to the next page which is 11, where we traditionally show the movements in terms of capacity and in terms of unit revenues.

So what we are seeing is basically a lower unit revenue reduction, a more intense revenue reduction that we saw in Q4 last year, and basically it's concentrated into two areas: on one side North America, North Atlantic; and in the other side, Asia Pacific.

When we talk about North Atlantic, we basically will be telling you about two different periods. So on the first period, which includes both January and February, we are seeing similar trends, and similar I would say underlying reductions as we saw in Q4.

Turning into March, we are recognizing a steeper reduction and, of course, it has to do with two main impacts.

On one side is Easter holiday which, of course, traditionally depresses the corporate travelling, the business travelling; and again, it has been the case in March this year, especially important in the case of British Airways, but also affecting Iberia.

The second significant move, significant change, has had to do with the Brussels impact. As you know, Brussels impact will be accounting for 10 days out of 31 days in March. It's about 10% of the period of the whole quarter. So it has had a significant impact on this 10% of the period.

It's difficult for us -- and we are not going to try to do it -- difficult for us to differentiate how much is exactly due to Brussels, how much is exactly due to Easter holidays, how much is exactly due to underlying corporate slight downward trend that we are seeing in some sectors again, especially fuel, of course, and a little bit of financial institutions.

So this is basically the reason why North America unit revenue reduction is getting to 7.1%, and very much also behind Asia Pacific unit revenue reduction, a big one, in this case also related to capacity increases; capacity increases basically having to do with Tokyo routes, especially Haneda with Beijing, with Shanghai; and, of course, with Kuala Lumpur.

So practically one-half of the Asia Pacific capacity increase that we're recognizing it's due to Kuala Lumpur, I would say, starting up a route.

So apart from this, I would say, mentioning on North America and Asia Pacific unit revenue trends, the rest is looking very much the same shape as Q4. So we see, of course, Africa, Middle East, suffering from low fuel prices in oil destinations, in oil-related countries. We've been adjusting capacity there. And in terms of unit revenues, we've been stopping the bleed, and that's a more stable now trend into the remainder of the year.

Even Latin America we see a more stable trend. Of course, there is still weakness in Brazil and Venezuela slightly; weakness in Mexico as well. But we see a strong performance in Argentina; we see a stronger performance as well in Central America and the Caribbean.

And in terms of Europe and domestic, we also see, I would say, similar trends as the one that we recognized in Q4. In the case of Europe maybe stronger unit revenue trends for the Spanish companies. In the case of the domestic, probably the better performance has been in this case for British Airways.

So moving to page number 12 where we are basically analyzing a little bit of the different trends in the different products.

Nothing new; everything expected. We see a weaker trend in the case of premium traffic. Again, same reasons in the long-haul; has to do with corporate weakness, Easter holidays and Brussels.

In the short-haul we see basically weak trend in the case of Iberia, and a quite, I would say, stable one in the case of Vueling. So for Iberia, it's basically domestic traffic, and very specially Canary Islands. Canary Islands has also longer stage length than the rest of the domestic network for the case of Iberia. That's also trending down the average of unit revenues for the Spanish company.

Non-passenger slight weakness has to do again with the cargo revenues which are rolling over the strong period that we had last year, the whole sector had last year because of the port strikes happening in Q1 year 2011.

So when we get to page number 13, I think, again, it's recognizing strong performance, good news at IAG level. So both including and excluding Aer Lingus, we are reaching a level of return on invested capital of 13.7%, taking into account the four previous quarters, so Q1 and the three behind.

That very strong performance is getting closer to what we thought was going to be the average of the period, 15%. But remember, we are on the first year so this is a very significant improvement. It's about 4 to 5 percentage point increases in Q1 in terms of operating margin, so we're satisfied by this RoIC performance.

We're also satisfied because three out of our four companies are reaching a 12.6% RoIC performance in this first quarter. And Iberia is lagging behind, but we are confident that through the remainder of their Plan de Futuro actions and efforts, they will be getting to very similar figures.

If we get to page number 15 where we are analyzing our balance sheet and financial stability, we're recognizing that since December last year we have been improving our in-balance sheet gearing from 27% down to 25%. This is basically because improvement through the quarter on our cash and cash equivalents positions, and this is a seasonal impact.

You have to take into account that the booked and not flown revenues that we got at December into the two first quarters of the year seasonally are always lower than the ones that we get in the month of March. So this seasonal adjustment is bringing cash improvements of circa EUR1 billion for the Group. Good news, but it's nothing really extraordinary.

When we get global comparisons, taking into account operating leases, our adjusted gearing has been remaining at 54%. Our adjusted net debt to EBITDAR has been improving slightly from 1.9 times to 1.8 times.

So as a summary, a very stable and a strong balance that we are keeping through this year, 2016.

Finally, page 17 basically summarizes the outlook guidance that we want to share with you in this occasion. It's basically about the messages that we have been explaining to you through this presentation.

So revenue trends in quarter 2 affected by Brussels, affected by some softness in underlying premium demand. Part of that underlying premium demand is Easter, and there is also another part having to do with corporate underlying softness.

As a result, IAG has taken already some actions in terms of moderating its short-term capacity growth plans, basically in areas of the world where there is underlying weakening of demand.

The Group also expects and reconfirms its expectations of reducing its underlying ex-fuel unit costs by 1% for the full year. So on these grounds consequently, we are still expecting to generate an absolute operating profit increase similar to the one that we were achieving last year.

Thank you very much, and we're now open to your questions, please.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Neil Glynn, Credit Suisse.

Neil Glynn - *Credit Suisse - Analyst*

Three questions from me, please. The first one. With demand falling like it has been on the Trans-Atlantic, arguably this is the biggest test for the Trans-Atlantic joint ventures that we've had over -- well, since their emergence, I'm just wondering whether you think whether it's from an IAG/American perspective, or more broadly in the market, is there significant room for improvement in Trans-Atlantic JV mechanics to help with pricing and commercial performance in this kind of environment?

The second question. Obviously, unit revenues are suffering from demand, but ex-fuel unit cost declines are also moderating with the lower-hanging fruit having been picked to a degree, and it makes your performance look a little more like your peers than it has done in the past. So I'm just interested in your perspective as to how do we ensure, or how do you ensure the margin gap is preserved or even widened into the medium-term.

And then just maybe more of a housekeeping question on the fuel slide. I think that the 2016 numbers are based on $400 per metric tonne, but as we look towards the end of this year, the forward curve is getting well above $450. So just interested. How should we read the second half, but also particularly 2017? Is there is some recognition of the forward curve within the year-on-year deltas on the slide?

Thank you.

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

Okay, Neil. We'll just correct you. Demand is not falling on the Trans-Atlantic. Demand is continuing to grow. It's not growing as fast as maybe people had expected. So the situation on the Trans-Atlantic in Q1 was definitely impacted by the events in Brussels following on so closely from the events in Paris, and a bit of Easter. But the softness in premium is in line with what we had mentioned previously.

I think the mechanics of the joint business work well in all scenarios. So we're very comfortable with the Trans-Atlantic performance. We expect the Trans-Atlantic to continue to perform well for us, and we're looking at a third-quarter performance that should be particularly strong.

In relation to our ex-fuel unit costs, there's still a lot more that we can do, and we will do. And I think the gap between us and our -- I think you call them peers, I'm not sure that's a term I would use, but I expect that to continue to widen.

We have quite a number of initiatives on track and we will accelerate a number of those to ensure that we offset any softness that we see in the revenue line with an improvement in the cost performance. Hence the reason that we're comfortable that our bottom-line performance will remain in line with our expectation, which in fact will mean some additional margin growth in the current year.

And fuel. I'll just remind you that the fuel charge is a scenario. We're not giving you a forecast of our fuel bill. We've given you all of the information that you require and you can plug in the figures based on the data we've given you and the chart that we've shown in the presentation which will enable you to make your judgment in relation to fuel.

However, what we do see is that given the hedging position that we have, this year, our fuel bill will be in line with our internal expectations. And also, as Enrique said, we're looking at a continuing tailwind on the fuel bill going into 2017 as the hedges that we've put in place continue to be effective and the lower oil price, even taking the current forward curve into account. So we still see some significant benefit accruing to us in 2017 as a result of the reduction in the oil price.

So all in all, I would describe the general environment that we're seeing at the moment in Q2 as being impacted more, we believe, largely by a number of external events, including some uncertainty around Brexit. I think there's certainly anecdotal evidence to support some corporate activity being softened as a result of that. But Q3 for us looks good, and you should expect us to continue to take measures in relation to our cost performance to offset any underlying softness that we see in the revenue environment.

Neil Glynn - *Credit Suisse - Analyst*

That's great. Thank you, Willie.

Operator

Andrew Lobbenberg, HSBC.

Andrew Lobbenberg - *HSBC Global Research - Analyst*

I wanted to just ask about the performance by operating company because you haven't given us, I think, the unit cost and unit revenue metrics this quarter. But if we look at the operating margin performance of the different companies, it looks to me like we've had quite a sharp increase in the operating margin at British Airways year on year, and we've got a reasonable reduction at Vueling.

And given that you've been discussing the softness of premium, the impact on Brussels and Paris on US and Asian bookings, that's slightly counterintuitive to me because I'd have thought that would be impacting the yield performance at BA. So quite keen to understand where there might be any pressures on the operating margin at Vueling in the quarter and what's giving us the really good performance at BA, please.

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

Thank you, Andrew. I should say -- by the way, I must invite you to celebrate my 55th birthday later on this year because I understand you think I will be departing some time around then, which I won't be, but I will be around and we can have a drink and discuss all of these finer issues at that stage as well.

But we don't break out the performance of the operating companies in the quarter. We'll be doing it at half year and full year and giving you all the detail.

But I think the performance of all of the operating companies in the quarter was in line with our expectations. In fact, our -- Vueling, without going into the detail, Vueling performance was slightly ahead of our expectation for the first quarter, so -- and the operating companies all performed broadly in line. There was a little bit of up and down, but Vueling was actually ahead of our Q1 expectations.

And in relation to British Airways, the -- as we said, generally in all of the companies, the first two months, January and February, revenue trends were very much in line with our Q4 revenue trends. But the March trend was definitely impacted by Easter, as we would have expected, but much more so, I think, by the events in Brussels.

We'll have a better view on all of that as we go through this quarter. Aer Lingus has taken some pricing action on the Trans-Atlantic to address that. They moved a little bit ahead of the other companies. We're looking at trends in the third quarter as being very much in line with what we would have expected to see, but certainly, second quarter has been disrupted by a number of external events.

But we don't see that continuing into the third quarter and we'll be happy to give you more details on the OpCo performance at the half-year presentation.

Andrew Lobbenberg - *HSBC Global Research - Analyst*

Glad you're sticking around, mate. See you for that beer.

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

You're welcome.

Operator

Stephen Furlong, Davy.

Stephen Furlong - *Davy - Analyst*

A question on -- I just want to go back to the Trans-Atlantic. Maybe, Willie, you might just talk about the supply/demand dynamics. Some of the US airlines talked about a lot of supply on the Trans-Atlantic, but I think it ameliorates a bit, and certainly in Heathrow as we go into the peak summer.

And then on the demand side just some comments on the way the exchange rates are moving and the flows of traffic between the point of sales US to Europe, Europe to US, and just really on that dynamic, that will be great.

Thank you.

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

Yes. Thanks, Stephen. You're quite right. When we looked at the supply dynamic across our network, particularly at Heathrow, it is benign. We're cycling over still in the second quarter some significant increases that went in last year from Delta, but that washes out as we go through May.

Third-quarter supply at Heathrow will actually be slightly down on last year given the change in gauge of a number of the operators. And the London market, we have seen some additional capacity principally coming in from Canada, more so than the US. And then in Europe, yes, there's -- I think Europe has seen more capacity from Europe to the US.

But the core markets from an IAG point of view, we believe the supply situation is actually okay as we go through this year with demand very much in line with our expectations in the third quarter, disrupted in the second quarter. And we saw that across all of the operating companies on the Trans-Atlantic. But third-quarter demand environment continues to be very much in line with what we would have expected.

So generally, we're comfortable, in fact very comfortable with what we see on the Trans-Atlantic. The softness in premium are in segments that we expected to be soft. The banking sector has been weakening for some time, and that hasn't surprised us, but we have a pretty diverse customer segment base on our -- or in our premiere cabins, and we're comfortable that any capacity adjustments that need to take place, if they do, we can do that relatively easily.

So overall, I'd say Trans-Atlantic continues to be a good and strong performing part of our network.

Stephen Furlong - *Davy - Analyst*

Okay. Great. Thanks.

Operator

Jarrod Castle, UBS.

Jarrod Castle - *UBS - Analyst*

One for Enrique first, but just on the fuel retention, I think you said that about one-half of it was retained. Do you have any expectation in terms of how much retention will occur during the rest of the year? Should we expect that level of retention to fall?

Secondly, some of your peers are talking more about consolidation, the likes of Lufthansa with low cost, etc. And I think, Willie, at the full-year results, you said there's nothing you're really looking at but you'll continue to evaluate opportunities as and when. Any thoughts for the industry and yourselves?

And then just lastly, I think come October, ICAO will put out a draft document looking at a global emissions scheme for airlines, and just interested to get your thoughts and any views on how that is progressing and potential impact for the industry.

Thanks.

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

Yes. As you know, because we've been quite explicit about it, we don't believe so much in the percentage of fuel retention as a driver. So we believe in demand and capacity in the different markets and also competition moves as the real driver of the way we can improve and optimize our unit revenues.

But on a type of looking behind and looking to the past exercise, yes, we think this quarter has been about 50% retention, and that's a level that probably we should keep or improve for the full year. With ups and downs, as we told you, Q2 is going to be softer than the average. Q3 will be stronger than the average. But as a whole, I think somewhere above 50% would be reasonable to be expected; again, not as an intention, not as a driver, but as a consequence of our actions in terms of capacity and unit revenue optimization.

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

I was pleased to read some comments from Carsten Spohr in relation to consolidation. You've heard me talk about this for some time. I believe consolidation will benefit the industry within Europe, and I think there are some things that make sense to various different airlines around Europe. And what makes sense to Lufthansa doesn't necessarily make sense to us, but that doesn't mean what they're doing is wrong. In fact, I think what they're suggesting is absolutely right for them.

We have said that we don't see any particular options for us at this stage, but we are continuing to keep an open mind and continuing to evaluate potential options, though we're not actively involved in anything at this stage.

But I do firmly believe that we will see further consolidation in Europe as we go through 2016, and some moves may unlock some other moves. So we're ready to take advantage of any opportunity should the right opportunity come along.

In relation to ICAO, we're very optimistic that ICAO will agree on a global mechanism to apply to the airline industry. We're actively involved in the process through IATA. We have got strong representation on the industry groups dealing with this from an IATA point of view.

And as you know, the IATA AGM is being held in Dublin in June. I take over as Chairman of IATA after that AGM, and we will be pushing for the industry to agree on a global economic mechanism, market-based mechanism, and we're very optimistic that this will be achieved at the ICAO assembly in September/October of this year.

Jarrod Castle - *UBS - Analyst*

Thanks very much.

Operator

Oliver Sleath, Barclays.

Oliver Sleath - *Barclays - Analyst*

Three from me, please, firstly on demand and supply and how you think about managing it. I hear what you say about demand is still growing and being resilient in markets like the Atlantic, but there does seem to have been across the industry a weak pricing environment for over a year now.

When you think about managing the business, do you believe it's important to try to get IAG back to flatter unit revenue trends over time? Or do you tend to focus on the fact that margins are still going up and you're growing with naturally lower revenue units like Aer Lingus and Iberia and, therefore, you would expect some level of yield softness within the business?

Second question on maintenance. I believe the Group maintenance initiative under Luis might be reporting back soon. I just wondered if there's any initial findings you could share with us. Presumably, you'll be looking quite hard at a move towards more outsourced maintenance and any [potential] timing on that.

And lastly, just on the remedy slots at Heathrow, I think there were some headlines about a few other carriers looking at taking that up on the UK domestic. Do you really think that will come to anything? And can you relatively easily hand those slots back from BA to somebody else if they want to have a go at it?

Thanks.

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

Thanks, Oliver. I think one of the things that sets us apart, and has set us apart, is our focus on our cost performance which clearly is important in an environment where there's uncertainty about revenue, and we will continue to do that. So in a --

I think what's different through this -- if you want to call it a cycle, I'm not sure it is; but in the past, airlines would have relaxed on their cost performance as they witnessed an improving revenue environment, and only now as you see a sort of softening revenue environment would have focused on cost. We focus on cost right throughout the cycle, and we will continue to do that.

So where we can influence price in terms of being a price leader, we will be seeking to clearly maximize the strength of our position then. But I think we've got a good mix of airlines within the Group. The mix we have with the lower cost units enables us to be competitive in any environment. And we're confident that we can continue to grow our margins, and indeed, on the -- through the cycle basis maintain significantly higher margins than we would have seen historically.

So I think the dynamics of the business are very different and much more positive from our point of view than they would have been. That doesn't necessarily apply to all airlines, but I think you're seeing widening gaps between those that will be resilient through the cycle and those that have continued to try and adopt the traditional boom and bust approach to their business.

On maintenance, nothing new to add to that other than the analysis that we're doing on maintenance is very comprehensive and has opened up quite a number of potential options for us. So we're absolutely clear that this represents further opportunity for IAG in terms of improving our cost performance while maintaining our high standards of performance in this area.

But there are several options that are available to us. All of those options are being fully evaluated. Most of them have been fully evaluated and we'll be moving later on this year into the implementation phase of the plans that we have on maintenance. So a lot of work to do there and the implementation of the changes will take place over some considerable time.

In relation to the remedy slots, I think it's fair to say that the speculation in the media is interesting, but to be honest, that's all I have. I've no insight into whether the suggested approach by Flybe is accurate or not. So all I have is the media speculation that you have.

I think it's fair to say that Flybe's brand in the UK is much stronger than the previous brands, whatever they were called. Oh, yes; Little Red, Virgin. I think the Flybe brand will definitely be a much stronger brand in the domestic market.

So if they are interested in doing it, I'm sure they'll move forward and make an application, but I don't know whether they have made an application.

In relation to handing over the slots if they do acquire them, yes, we've made full provision within the way we operate to be able to hand those over without any difficulty if somebody does come in and make an application for the slots that are approved by the trustee dealing with that. But it's very much in the hands of the trustee. We don't have any direct involvement in the decision to grant the slots if anybody applies for them.

Oliver Sleath - *Barclays - Analyst*

Great. Thanks Willie. Very clear.

Operator

Michael Kuhn, Societe Generale.

Michael Kuhn - *Societe Generale - Analyst*

Also three questions, and mostly about capacity. You have capped your plan by like 20 bps/30 bps. Could you give some more details where you capped and maybe whether it's more via frequency or aircraft size?

And also, in that context, in the case of further demand weakness over the second quarter, how much more could you cut? And let's say what are your -- what is your capacity range in different scenarios over the course of this year?

And then I know it is difficult to answer, but Brussels is like five weeks away now, and April almost done. How did the month go; and did you see some kind of reversed Easter effect. So maybe just some more additional comments on the current trading?

Thank you.

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

The capacity reduction, so we've used all of the normal levers, if you like, within the business. So we've cut frequencies in some areas. We've eliminated certain services. So the areas where we've cut back on frequency, principally into Brazil where BA and Iberia have cut back on their frequencies to Sao Paolo and Rio de Janeiro, and there will be some further reductions in frequencies as we go through the year.

We've also taken the decision in Iberia to cancel some services. So Luanda, Lagos, Accra, Istanbul, we've now cancelled those services, so that's leading to some of the capacity reduction.

And we have flexibility within the fleet, because most of those destinations in it that have -- well, in fact all of the destinations that I mentioned for Iberia are operated by short-haul aircraft, so we've got quite a bit of flexibility in the fleet to return aircraft on lease. And that's the critical issue we've talked about historically about having flexibility to adjust capacity.

So we've got quite a few levers that we can still exercise. We don't see any real capacity reductions in the third quarter other than the route cancellations that I've talked about because we see those as just being structurally weak markets from an Iberia point of view. But if we need to reduce capacity in the fourth quarter, there is quite a bit of scope within all of the airlines to reduce capacity and take aircraft out of the fleets, given the flexibility we have around the operating leases. So I think we're in a good position there.

On Brussels, the one thing I'd say, we're still not back to a full schedule in Brussels, so Brussels airport is still not operating at its full capacity. So there is some underlying capacity issues on the Brussels market.

It's still too early to call, to be honest with you, because normally, we would expect things to recover to what we'd call normal patterns in about five to seven weeks. I think because of the proximity of the Brussels event to Paris, that might be slightly extended, so I wouldn't call it at this stage.

We believe that it is having an impact in the markets that we talked about and that those trends are likely to continue through the second quarter. But the good news from our point of view is the third quarter trends at this stage appear to be very much in line with what we would have expected to see in the third quarter.

So I don't know whether everything will have washed through as we finish the second quarter, but certainly, it looks like that is the case when we analyze our third-quarter booking profiles.

Operator

Andrew Light, Citigroup.

Andrew Light - *Citi - Analyst*

Just three questions, first of all on Aer Lingus. Can you give us an update on the integration and the opportunities you see there as you go forward?

Secondly, on British Airways, has Alex Cruz given you any heads-up about what he thinks he can do in terms of new opportunities there?

And then thirdly, how are you thinking about the long-haul, low cost threat, particularly at Gatwick where Norwegian obviously has some grand plans. You've got WestJet and Air Canada rouge, and I heard even JetBlue are considering Atlantic operations.

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

On Aer Lingus, the integration has gone extremely well. We're very pleased with the performance and very encouraged by the trends that we've seen in Aer Lingus. So I would say there's -- most of the work that needed to be done has actually been completed ahead of schedule. The next big integration issue will be Aer Lingus coming into the joint business on the Trans-Atlantic. That requires some systems changes; all of these expected.

So the next two big bases for Aer Lingus will be oneworld entry and joint business on the Trans-Atlantic. But the business is performing ahead of expectation, and the integration where we've needed to do some work has gone on very smoothly and is ahead of plan. So nothing but positive news in relation to Aer Lingus.

Alex sent me a text message to say he's looking forward to talking to me about business; but he is sitting here opposite me but he hasn't opened his mouth to tell me anything yet. But he's smiling, so I think he has some good news for me. I won't ask him to say it publicly, but we're expecting great things from Alex. There's no pressure on him. But very pleased with Alex and Steve. The move into BA has gone very well.

And on long-haul, low cost, this is something that we've watched with great interest. We believe we have the best low-cost long-haul operator out there, and that's Aer Lingus. They're doing exceptionally well; very profitable. Much more profitable than Norwegian. I think there's strong evidence to support that both on a historical basis and current operating performance. So we've got options available within the Group.

The competition we see here is what we had expected to see. So with the development of aircraft like the 737 MAX and the A321neo LR, you would expect more and more people to look at its narrow body operations on the Trans-Atlantic.

But they're options that are available to us as well, so there's nothing that we've seen there that changes our view or requires us to change our approach. We can compete very effectively with Norwegian. We're operating from Gatwick with British Airways; and as you know, we've announced a Gatwick/JFK service as well.

So the market, I think, is fine. The demand remains good. There's plenty of room for everybody. But the difference between those that are putting this long-haul, low cost label on their operations and us is that we've already proven we can do it and do it profitably. I'm not sure that the others have actually demonstrated they can do that.

But there's some interesting issues in relation to the customer proposition that are providing us with some encouragement and some ideas as well, so I think it's an area that you'll see some more competition and some potential service innovation issues as we go through 2016 and into 2017 from an IAG point of view.

Andrew Light - *Citi - Analyst*

Thanks. Can I just ask on Aer Lingus, what's your expectation of timing of entry into oneworld and the JBA?

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

It's not finalized yet, but we always took the view that it would take somewhere between 12 to 18 months; so I haven't seen anything that would make me change that view. But Aer Lingus can continue to operate efficiently.

What we are doing, however, is looking at future plans on the basis of Aer Lingus being part of the Trans-Atlantic joint business. So some of the new Trans-Atlantic destinations, and maybe some capacity adjustments, increases that we'll be looking at from Aer Lingus, are predicated on their involvement in the joint business, because that gives them opportunities that wouldn't have been available to them as a standalone operator on the Trans-Atlantic.

Even though they have had a good relationship with United and with JetBlue in terms of feed, the benefit of the Trans-Atlantic joint business is significantly greater than anything they could have achieved on their own. So the plans going forward assume that they will be in the joint business sometime in 2017, but an exact date has not yet been agreed.

Andrew Light - *Citi - Analyst*

Okay. Thanks very much, Willie.

Operator

Mark Simpson, Goodbody.

Mark Simpson - *Goodbody Stockbrokers - Analyst*

Just two questions on costs. I probably missed the clarification about the unit cost reflation of landing and route costs that were up 17% year on year. I just wondered if you could just run past what's expected on that front going forward.

What was good was obviously employee unit cost down 2.5%. I'm wondering on that if there's any update on what you're planning with regards ground staff at BA.

And then, finally, obviously, clearly confident about Q3, but I'm just wondering if you could give us some feel for forward bookings, how that comps year on year to where we were and also against expectations. So if you could cover those, that would be great.

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

Yes. On unit cost landing fees, the big increase quarter against quarter has to do basically with the compounding of two effects. On one side, we had last year a reduction in the cost basically due to release of provisions that we had for increases that may have happened that year, and that has been combined with a real increase happening in year 2016. And it's very much related to overflying fess of Russia, and on a lesser extent to landing fees in Japan.

So that's the combination of two one-offs that will be basically paid in out through the remainder of the year.

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

In relation to employees, the employee cost performance and productivity improvement continues to be good, and there's clearly more scope for us there, but we've no significant new initiatives. So nothing new to add in relation to any of the operating companies at this stage. But particularly directly in relation to the question you asked about BA ground handling, no new initiatives. So nothing to talk about in relation to that.

And on Q3, our forward bookings are in line with our expectation and matching the increase in supply that we put in there. So at this stage, Q3, all of the trends we see are very much in line with what we had expected to see for that quarter. There's nothing that we can point to that would cause me to make any comment.

So it's -- looking through the network, it's very much in line with what we would have expected to see and clearly shows an increase, given that we've increased the number of seats that we have in the market in the third quarter.

Mark Simpson - *Goodbody Stockbrokers - Analyst*

Is it fair enough though to say, given the previous guidance and you always were suggesting that Q2 would be weaker than say, Q3, but because Q2 seems to be weaker than previously thought, that actually Q3 is looking to be stronger than you'd previously thought because it's obviously balancing out in unchanged guidance for the year?

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

Well, the thing I've said about unchanged guidance is, don't forget, we're going to accelerate some of our cost initiatives as well. So some of these issues I think you've got to look at as self-help. Where we see softness in the revenue, we address that, and address that quickly by looking for additional cost reduction opportunities for us, or accelerating cost reduction initiatives that we had in the plan.

But I always felt that there was some potential upside in the third quarter. I didn't have any visibility about the impact of the Brussels terrorist event. But when we look at Q3, there is certainly good reason for us to be optimistic about the Q3 performance, and I expect that to be very strong relative to historical Q3 performance.

Q2 will be a good quarter for us relative to our historical Q2 performance, but it's not going to be as strong as we had expected for the reasons that we've already outlined.

And Q4, we continue, obviously, to get the benefit of the fuel price reduction in the fourth quarter and the general environment that we see, although it's very early.

So I wouldn't say too much about the demand environment in Q4, but we don't see anything in terms of the supply, given the visibility we have at this stage, to cause us to change our view in relation to the fourth quarter. But clearly, as we go through the year, we'll give you an update in relation to performance in those quarters.

Mark Simpson - *Goodbody Stockbrokers - Analyst*

That's great. Okay. Thanks.

Operator

Suzanne Todd, Morgan Stanley.

Suzanne Todd - *Morgan Stanley - Analyst*

I've got two questions for Enrique, please. First, on the effective tax rate for the full year, could you give us some guidance? I note in the first quarter it was quite low at 16%.

And secondly, to come back on your comments about domestic Spain and the Canaries being quite weak, can you give us some more color on why that is? Is this the consumer demand is now weaker? Is it a pricing reaction to competition? Just some more color on that, please.

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

Sure. The tax mix on the first quarter is, naturally, I would say, below the average we expect over the year, because in the first quarter, we have both companies still on losses and companies that are already on profit, so the mix gets especially benign. It's at 16%. What we expect for the full year is something more in the range of 20%/21%.

In terms of the domestic Spain and the Canary Islands, we are seeing strong demand there; also significant competition. And basically, the effort of the Group is to keep our market share there and our connecting traffic into the rest of our network.

So there's a lot of competition taking place there, but because we are using on the Canary Islands our low-cost tool in Iberia, so Iberia Express, we're still making a reasonable amount of money on those routes and competing very efficiently with others as Norwegian, Air Europa, or even Ryanair.

So we're happy, and we are still, I would say, making some very significant money in these routes. But, of course, in terms of unit revenue impact, because of competition, and also because of stage length, it creates a negative impact.

Suzanne Todd - *Morgan Stanley - Analyst*

That's comprehensive. Thank you.

Operator

Edward Stanford, Lazarus.

Edward Stanford - *Lazarus Partnership - Analyst*

My question has been covered. Thanks.

Operator

Andy Jones, RBC.

Andy Jones - *RBC Capital Markets - Analyst*

It's more of a follow-on Spain but with particular regard to the BA Holidays. I think we've seen a bit of a leisure shift towards Spain ahead of the summer. I was just wondering how you're positioned to use BA Holidays as a tool to maybe gain some advantage over your competition in that market.

And then a second question on capital. Given the -- have you got any changing thoughts on what cash might be generated above the dividend, be it more CapEx, pension pay-down, debt reduction, or indeed a higher payout, given the changing environment that you've seen over the first quarter?

Thanks.

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

Yes. BA Holidays is performing very well and we're pleased with its evolution. I think there's more to come. I think one of the issues, although we're seeing strong demand into Spain, securing the additional hotel rooms in the current environment is difficult.

So there is upsides, but I think everybody's scrambling to get those last few rooms. But BA Holidays certainly has seen a very strong performance, and continues to develop, giving us good reason to be optimistic about the potential for BA Holidays into the future as well.

In relation to CapEx, no change to our CapEx plans in relation to cash generation. Clearly, we're continuing to do very well. There's strong cash generation within the business. I think the issues you've talked about are issues that will be relevant for us to discuss internally and with our Board towards the end of this year.

So we've got no change to plans, although I expect our cash generation this year is going to be stronger than we had budgeted for. We don't have any new significant issues to highlight with you at this stage, but clearly, when we come to Capital Markets in November, we'll talk about that in more detail.

Andy Jones - *RBC Capital Markets - Analyst*

Great. Thank you very much.

Operator

Johannes Braun, Commerzbank.

Johannes Braun - *Commerzbank Corporates & Mkts - Analyst*

Just one follow-up from me on the comments you made regarding the Canaries. I was just wondering if these trends are potentially improving going into the summer. And my train of thought here is regarding the influx of leisure traffic coming into Spain because of the events, terror events that happened in North Africa and Turkey, and so on.

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

Yes, they did, they are, and we've seen very strong seat factors. As I said, one of the -- maybe the limitation, or possibly the only limitation will be hotel beds being available.

But the general environment in the Canary Islands is competitive. As Enrique said, we're pleased with our performance because we're competing in that market with our low-cost, both Vueling and Iberia Express. And given the cost base of those being significantly lower than some of the competitors, the environment, I think, is generally very positive for us while being potentially negative for some of our traditional competitors on that route.

So it's a market that has seen a lot of capacity, but we're pleased we've been able to utilize the low-cost arms of IAG to be very competitive in that environment.

Johannes Braun - *Commerzbank Corporates & Mkts - Analyst*

But in terms of supply and demand, is demand going into the summer compensating for the capacity increase that we're seeing on these routes?

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

Yes. The aircraft are definitely full so the demand is particularly strong. We expected that to be the case in the third quarter. But as I said, I think the limitation in providing additional capacity, if we were able to do that, will be hotel beds in the Canary Islands because I think pretty much everything is booked out at this stage.

But there is good demand on the routes with very encouraging seat factors across all of our operations because we're flying there from -- all four of the airlines in the Group are operating to the Canary Islands and seeing good demand.

Johannes Braun - *Commerzbank Corporates & Mkts - Analyst*

Thank you.

Operator

Thank you. There are no further questions in the phone queue. I'd like to turn the call back over to you, Mr. Walsh, for any additional or closing remarks.

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

Okay. Thank you very much, everybody. Clearly, we're pleased with a strong financial performance in our first quarter; pleased to be able to maintain our guidance that we've given you for the full year, and look forward to talking to you at our half-year results.

Thank you very much.

Operator

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