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IAG.L - Half Year 2017 International Consolidated Airlines Group SA Earnings Call

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PRESENTATION

Andrew Barker

Ladies and Gentlemen thank you very much for coming. We know there are other investor calls going on at the minute, so we're very grateful for your attendance. There will be people attending on the conference call as well and just to let you know at the end, we'll have Q&A from this room first and then we'll switch to the conference call for anyone who can't make it in person. So without further ado, I'd like to hand over to the Chairman. Thank you very much Chairman.

Antonio Vazquez Romero - *International Consolidated Airlines Group, S.A. - Chairman*

Good morning, everybody and thank you for coming. I do insist what Andrew said that bearing in mind that our colleagues of Air France are making the presentation on the side and talking likely about some exciting things today. We doubly appreciate that you're here with us and I just was to emphasize first of all that we are very happy with the strong result that we are presenting to you today and I just want to present a couple of milestones that we are having. First of all, in terms of operating profit half one this year, we reached almost EUR 1 billion and then we take only the quarter -- the second quarter, its -- we made in the second quarter more than in the whole year of 2013, which means it's a healthy evolution of the group.

Second in terms of passenger unit revenue, we're positive on a year-on-year basis by the first time over 3 years, which is wonderful news. In terms of ROIC, by the first time, we will reach our target of 15%. And in the period between March and June, we did complete the EUR 200 million share buyback out of the EUR 500 million program that we presented to you some months ago. So I hand over to Enrique to go ahead with the financial presentation.

Enrique Dupuy de Lome Chavarri - *International Consolidated Airlines Group, S.A. - CFO and Executive Director*

Good morning, everybody. Thank you, Antonio. So as it has been said, we're going to be explaining you what we are labeling as a very strong set of results of IAG group for the second quarter of the year. When we talk about very strong, I think we should be referring this is -- I would say the highest improvement on quarterly year-to-year profit since the end of year 2014. So it represents a significant type of step-up in terms of how we have been progressing our results through the last I would say 3 years.

Of course, you will see, we will explain that part of this exceptional results have to do with some type of one-off circumstances, some base effects. At the same time, we want to insist that we still see a positive or very positive underlying trend in the way we were looking at future progress on our operating profit results for the following quarters. So we need to refer to significant type of references for this EUR 805 million that we have been disclosing as the operating profit of Q2 '17.

Of course, we need to refer to passenger unit revenues. Passenger unit revenues for the quarter have been increasing by 4%. This is, as you know, quite -- exceptionally it's high-end of the range. Of course, it has to do with some type of seasonal effects and we have to mention Easter. So Easter this year '17 has been timing -- timed in a different way as last year, and that makes a difference, it makes a positive difference. When -- we've been trying to make some evaluation of that difference, we reached a conclusion that maybe around, I would say, maybe 2% or so of the revenue increase could be allocated to this type of Easter effect. There are also some other one-off or base effects that have been helping us through Q2 and I will refer to those in the following slides. But after saying that again, underlying trends appear positive.

We have to refer also to ex-fuel unit cost and then again this time I have to mention some exceptional circumstances so the British Airways disruption on the long holiday -- on a long weekend end of May, it's probably a very type of above high profile one that we need to mention. We'll be very explicit, we've been telling you that it's about GBP 56 million, so around EUR 65 million of additional costs that we have incurred or provided for the purpose. Maybe the final figure is going to be slightly lower than that, but that makes a significant type of -- a big chunk out of the 3.5%. It makes around 1.6%, 1.7%. There is some underlying ex-fuel unit cost increases that we are going to be explaining. We feel still comfortable about non-fuel unit cost being under control and the general trends being positive, being basically -- the underlying trends, the ones we were pursuing.

So in terms of capacity and traffic also, I would say some good news, ASKs capacity growth as we've been telling you this year will be a lower level of growth when compared with the previous years and it has to do with, I would say some targets that we have been announcing you especially in November last year. They have to do with Vueling and Iberia and also British Airways. Basically it was aiming in the case of Vueling to a stabilization and recovery program. In the case of Iberia, it was more related to Latin American weakness and that's what we are going to be talking about. British Airways is also referring to capacity and future type of demand trend.

So let's go with a little bit more detail of what has happened in the quarter in terms of revenues and costs. So if we are a little bit more precise, the EUR 250 million on a type of constant currency basis should be translated into EUR 262 million. So the net forex impact for the quarter has been just EUR 12 million. This is also a good news because it shows that the famous sterling translation impact that we had very heavily through last year now is getting less and less type of impacting. At the same time, the weakness of the dollar -- the late weakness of the dollar against specially the euro has made us some type of improvement, especially on the transactional side. So the net is just a minus EUR 12 million.

Some type of interesting novelties here, of course, as we've been telling you on the passenger revenue side, the price mix positive impact is, I would say, very relevant this quarter. It makes up to EUR 210 million of improvement. Another good news has to do with non-passenger revenues. Here, we have basically 2 different trends or impacts, on one side, remember there we have the type of third-party revenues which are not strictly related to our operations. So MRO third-party business for Iberia, British Airways holidays in the case of British Airways, those impacts in terms of increased revenues, non-passenger revenues this quarter have been subdued.

On the other side, cargo revenues have been better. That's one of the novelties I would like to point out. There is probably a change in trend in the way cargo revenues have been performing since some quarters ago, good news. Of course on the fuel cost, again as we announced that price -- the net price after hedges, positive impact is there and its very relevant. On the ex-fuel cost, these are the issues that we are going to be commenting in the following slides, so there's some one-off impacts that we are going to be explaining that have made our life a little bit more difficult through Q2. So this is a little bit about it. The disclosed out-turn figure of ex-fuel unit cost is a very low one, it's negative in fact, but that's basically because of weakness of the sterling translated into euro terms.

The real underlying one is 3.5% and let's talk about the 3.5%. Of course, the 3.5% has very much to do with this British Airways disruption impact and its basically allocated on where we are -- say it's handling and catering costs. So the negative -- the quite intensive negative here -- that you see there on the price/mix type of element of those costs is more than 100% having to do with the disruption. So if we were to carve out disruption, then the underlying would be positive on that chapter. So that's a way to explain a part of the negative performance in non-fuel unit cost.

Second, we are talking about labor costs, employee cost and there we still have a good performance or a very good performance in the case of Iberia, in the case of Aer Lingus, even in the case of Vueling. So again, good news coming from Vueling and its recovery pattern out of the disruption of last year. I will tell you more about that one. There is a little bit of underperformance in the case of British Airways and this is basically related mostly to one issue, which accounts for more than 60% of the negative impact. It has to do with pension charges into the profit and loss account. So as you know, pension charges are regularly updated through a reference to interest costs. So interest rates prevailing in the market especially the AA bond rating is the reference that is used. So as you well know, when interest rates come down, the impact in the pension fund charges goes up.

So that's something that its out of our control. It has happened and it will be affecting us for the whole of year 2017. The good news is that today, if we take the same reference of AA bond type of yields in the marketplace, we shouldn't be applying this type of -- level of costs. So what is going to be a headwind this year would probably be at today's interest rate yield, a tailwind for next year. There is also a little bit of phasing on I would say pay awards that has a different calendar than in last year. So that is also not meaning a wrong type of underlying change in trend. The other one is ownership and again we have to mention one specific issue affecting ownership costs specially lease costs. So Iberia last year had to account and was benefiting through Q2 from a very significant release in a provision -- tax provision on withholding tax on leases.

So it was long and bit controversial with the Spanish tax authorities on the way we should be considering rental and then withholding on those rental payments. We won it. So we won it and we get the release of that provision. It was EUR 30 million of lower costs for last year. So that means as get into this quarter this year, we have had this step up of EUR 30 million, which accounts for nearly 70% of this negative performance. So that's one-off, one-time Q2 this year and it will be getting deducted through the remainder of the year. The rest has to do with of course our plan of new aircraft deliveries has been growing through the last quarter especially on a rolling 12 month basis.

This quarter, we have 19 more operating leases -- long haul leases we're talking about 787's and 330's for the group so that's the remainder. So again that one would be gradually type of spread and diluted for the following quarters and months. Again, we have to say here we have as you well know a mathematical negative impact. You know that bringing those leases means that the whole rental cost is allocated at the operating profit level. So there is about 1/3 of interest embedded costs in those rentals that are accounted now on those new aircraft, above the line of operating profit. That's a mathematical type of a difficulty that we adjust and we explain you very regularly. Of course, there are other benefits, very significant benefits in terms of flexibility and the use of equity on the operating lease concept that we prefer to keep. So that's basically how to explain this 3.8%.

As a whole, I would say it's high, it's very much related to specific issues and we are accounting to have -- to be getting into lower increases through Q4 -- Q3 and Q4. Fuel, it's a headwind, it's a significant headwind for the year. It has been both in Q1 and Q2. It will be again in Q3 as you see in the chart and more gradually in Q4 and at today's prices probably still marginally positive tailwind through next year. The references that we have taken for the chart is about $480 per metric tonne in the case of kerosene and 1.12 in the case of the value of the dollar. There is maybe a little bit of additional kerosene cost and maybe a little bit of lower price of dollar. So we're still comfortable with the chart there at today's prices.

So good news here again. Yes, what about our growth plans and how we are developing them? So as you see, the planned growth for the full year is 2.9%. We have been explaining this as a conservative level of growth. We are happy with it. It allow us to do some adjustments in our network and on our operations and they have to do very much with Vueling. For example, Vueling, as you see in Q3 is having even in the summer season a lower level of capacity than last year. So that's having a very significant and positive impact on unit revenue as you will see and it's also enabling Vueling to adjust their production platform in a much more resilient way. So Vueling will have in the future -- we were telling you about this issue in November -- will have in the following future a much more stable production platform, less peaky one, more resilient one.

So basically the challenge now is to be able to extract out of the summer season an optimization of unit revenues -- the passengers and to be able to improve the performance in terms of load factors and utilization on the shoulders and they are doing well as you will see, more than well. So as a whole, the big grower through the year would be Aer Lingus and that's something again we were telling you about with a 12.5% ASK growth and we'll see how it's going to be showing. It's being performed on a efficient or very efficient way. So we are seeing some improvements both in volume and margins at the same time. So it's a win-win impact. For Vueling, it's a low growth level as I have been explaining. For Iberia, its lower than last year, but still it's going to be about 4.9% for the full year and there is going to be some opportunities of recovering growth this year, but maybe more next year because there are some demand opportunities there.

And for British Airways, it is also a low level of growth, which is going to be just 0.4% through the summer season and then 1.2% for the whole year. So this is basically where the different OpCos are going to be growing. As you see, Aer Lingus is going to be basically opening some new routes into the U.S. which we have mentioned in Miami and there will be others coming. The impact in the case of Aer Lingus of a greater stage length which has to do with a greater proportion of long haul into their network combined structure is very relevant.

In the case of British Airways, the new routes basically have to do with Oakland and Santiago de Chile, Fort Lauderdale. So basically the Pan-American continent. For Iberia, it's more about restore routes on a full-year effect. So it's Tokyo, it's Joburg, it's Shanghai. And for Vueling, I think I would be mentioning basically Amsterdam on this type of network restructuring that they are doing and on this type of effort of concentration of their operations on hubs where they are exercising leadership -- significant leadership. This is then again one that's bringing a lot of novelties.

In the case of ASKs, I'm going to be comparing unit revenues and ASKs on a region by region basis. So first maybe it's going to be around the domestic. The domestic has basically a bit of an expansion and mostly in the Iberia region. With an expansion of 5.8%, the domestic unit revenues are being kept flat and they are quite positive in most of the regions and then slightly negative in the case of the Spanish island, especially Canary Islands where there is a little bit of competition there taking place.

Next one is probably a different picture to the one that you have been hearing in the last weeks because it has to do with the European battlefield. And there basically what we are doing is we are concentrating our activities on our main hubs -- on the main markets in which we are exercising leadership. And the consequence in terms of unit revenues has been bright -- has been very bright. Of course, there is a bit of Easter holiday impact as well. So let's be as neutral as possible this Easter holidays impact especially in Iberia and Vueling, but there is also underlying positive trend. All of the 4 companies with exception of the high-growing Aer Lingus have had positive unit revenue performance in this European battle.

Asia-Pacific; Asia Pacific is also a story of lower growth, even slightly negative growth and it's a story of very strong performance in unit revenues and this has to do probably also with a low base in year 2016. The Asian traffics were affected -- significantly affected by terrorism impact and the warning of U.S. authorities last year on travelers into Europe. They are coming back and that's -- they are coming back strongly. So we are seeing some -- I think I was being asking about which routes I should be highlighting today to you, which is all of them. All of them are having positive unit revenue performance, so very good news.

Africa, Middle East, and South Asia is basically less relevant. We are having more growth and that's basically through de-tagging exercise that we did on some of our Middle Eastern routes. So Doha, Bahrain et cetera and its having still a low but a positive performance in unit revenues.

I prefer to switch to Latin America. So Latin America is having a bright exercise -- a bright year and this is coming from the recovery of Brazil. And not only Brazil, our network is also contaminating Argentina -- Argentina and more mildly Mexico. So Mexico is coming from the lows in the same way, Brazil is coming from the lows and it's in positive territory. So as you see Latin America unit revenue improvements have been absolutely substantial, more than 10%.

And then finally North America. North America as a whole a low level of growth, quasi 0% but it's a combination of low level of growth in British Airways, slightly higher in the case of Iberia, 25% for Aer Lingus. And that's explained a little bit -- sorry I was changing my circles-- this explains the 4.2%, but also explains a little bit the unit revenue performance. So this is as a whole, flattish performance but if we carve out the growth of Aer Lingus and we carve out the growth of new opened recently routes, especially British Airways, so we'll be doing an apples-to-apples comparison, same routes, same markets as last year, the underlying unit revenue trend is 2.3% up so its not explosive, but its showing that the market is there -- the demand is there.

So last remark here because I think it's very important to make it, what we are seeing differently than the previous quarters in Q2 coming into Q3, but especially early signs into Q4 is a better performance of corporate segment -- of corporate traveler, of business traveler. On maybe segments of the market that had been suffering through the last 3, 4 quarters, even maybe more as gas and oil for example, or as financial institutions. So these sectors are getting gradually out of the lows -- are starting to fly back. That's a very good sign, especially into the winter and that's why -- that's one of the reasons why we are betting on a positive unit revenue performance into Q4.

This shows a little bit the same. So long haul you see non-premium is positive, but it's a nice surprise on the premium market and that's having to do a little bit with what I was just saying. And on the short haul, again is positive surprises. Now Iberia and Vueling, very strong performance, but Spain is growing 3.5%, it has to show. So very important performance in the short haul, even for British Airways is positive, so good news. And this company-by-company, so this is euros, this is sterling, this is not constant currency terms. So the figures that you can be seeing can be a little bit extraordinary in terms of highs and lows. So that's why I would prefer to focus on operating result and the operating margin. So good to know that the 4 companies have been improving their operating results through the quarter. Well this is basically H1. It's more evident in Q2, but it's very important and very significant for all of them, but not only in terms of absolute figures, it's in terms of margins. So we see operating margin for Aer Lingus climbing nearly 2 percentage points. That was what I was trying to express before. So this very significant 14% ASK growth has been performed and achieved with a 1.7 increase in operating profit margin. That's quite exceptional.

British Airways again 2 percentage points of improvement in operating margin, getting to 11.5% on a half of the year which is not the best one as you well know. Its winter and spring. Well when it comes to Iberia, Iberia is really, I would say an overperformer of the group. It's 4.4 improvement in H1 in terms of operating profit margin. The same with Vueling 3.7% and then 5.6 percentage points of improvement in terms the lease adjusted operating margin. So very strong performance.

In the next chart, I'm going to be showing on similar type of metrics, but on the last 4 quarters, on the last 12 months so as to make a full unseasoned exercise. And this is how it shows. In this chart, we are basically referring to ROIC and nominal adjusted margins and on the last 4 quarters. So ROIC is getting to where we said it was going to be getting as an average in our plan, but earlier -- quite a bit earlier. So 15.1%, that's very good news and then the average for the whole period we mentioned in November in some month, is going to be probably climbing gradually up. And company-by-company, its again a very positive story. So for Aer Lingus, it's again very impressive. So operating margin trend there improving 2 percentage points. Nominal operating profit margin 14.8%, ROIC 22.9%. So it's really been able to preserve the level of profitability of this growth exercise that they are performing. For Vueling and Iberia -- for Vueling, it's a very sharp comeback. So operating margin trend improvement 5.6 percentage points, nominal margins already 9.5%, ROIC in the low season, again 9.7%. For Iberia again 4.4 percentage points of operating margin improvement and ROIC again on the low season 12%. And British Airways -- British Airways is already on the 14.8%, so quassi 15% ROIC level. So very satisfied by the chart and the way we are achieving our medium and long-term targets.

Below the line, so everything performing as it should with some volatility on the way. We need to treat some accounting rules. So in terms of net finance cash impact net income expense, we were minus EUR 135 million last half, minus EUR 98 million this half. It shows improvement in interest rates, it also shows an improvement on a net debt base in balance sheet debt base. So realized losses on derivatives is a little bit of a roller coaster, we had a positive last year, we have a slight negative this year. As a whole, net financial cash element have been gradually coming down with this volatility. Unrealised remeasurements of -- for example non-efficient hedges or translation impacts on forex have been the one taking the adverse hit. So they were positive last year and they are negative this year. As a whole, tax rates have been kept at similar levels of last year. The effective tax rate that we are having is 19.7%. So as a whole, profit after tax pre-exceptionals has a quasi 30% improvement against last year first half and the fully diluted EPS has more than a 25% improvement against last year same period. So very strong financial performance as well.

And then, just to end in terms of the balance sheet to our financial structure. December to June, you have to take into account that it's not apples-to-apples. So in June, we have an extraordinary rich position because of being having cash in a significant part of the sales of Q3 and that's why working capital brings a lot of positive in cash flow in the first half of the year. Having said that, I would say, on balance sheet, net debt is getting close to 0. Of course, we adjusted the -- including the aircraft lease capitalizations on a multiplier of 8x. Doing that, we get to a net adjusted debt figure, which is just EUR 7 billion, so EUR 1.1 billion less than at the beginning of the year. And that of course has a very positive impact in the ratio that we are using to follow our leverage, which is adjusted net debt to EBITDAR, which has been coming down from 1.8 to 1.4. This is not seasonally adjusted, it shows the performance of the first half, but it shows that we are basically getting to our targets. Remember we have this reference to our investment grade region, these type of metrics are absolutely consistent with investment grade region and they basically allow us to do a lot of things and to face the future with a lot of confidence. So Willie has some very interesting metrics as well.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

I just have a couple of slides which we'd hope we'd show you in terms of our performance. We've noted a number of our competitors are highlighting their punctuality statistics recently and rather than give you the information as we record it, we've looked at 2 independent sources of data, which allows us to compare our performance to those of our competitors. The first one is FlightStats and you can see there star performer is Iberia Express with Iberia very close behind. Very strong performance from British Airways and from Vueling. It is for the first 6 months including June of 2017. You can say therefore that our airlines are performing very, very well, ahead of most of our major competitors. This data does not include data for Ryanair and Wizz.

So separately, we looked at the CAA statistics and obviously you can check these for yourselves, but we've done the work for you. So we've looked at London short haul performance again measuring on-time arrival. The CAA data is only up to the end of May. At this point, it doesn't include June. Internally, our statistics show that our June performances has been very good, but again you can see this reaffirms Iberia Express as the star performer with Iberia very close behind. Very good performance from Aer Lingus. Excellent BA performance at Heathrow, outperforming everybody else at Heathrow. British Airways Gatwick performance 83%. When we look at some of our major competitors at Gatwick, easyJet lagging way behind, 71.5% and Norwegian, bottom of the pack at 66.4%. I'm unclear as to what the issues were in Air France to see their London performance being dragged so low at just under 67%, but it just demonstrates that alongside a very good financial performance, the airlines are delivering strong operational performance and of course the 2 go hand-in-hand. We look at punctuality principally because it's one of the major drivers of customer satisfaction and NPS and if we can get our punctuality consistently right and at high levels, we do see that driving through into a very positive performance on satisfaction and NPS. So I think right across the board here, very positive performance.

And then if I look to the outlook, we're amending the outlook and upgrading it and what we're saying now is at current fuel prices and exchange rates, we expect operating profit to show a double-digit percentage improvement year-on-year. Previously we had said an improvement. That clearly reflects a strong first half performance but it also reflects the fact that we believe our passenger unit revenue at constant currency will be positive in the second half of the year as well having seen a strong performance in Q2, reporting a 4% increase in constant currency passenger unit revenue and as Enrique said earlier, if you strip out Easter, which we believe accounted for about 1.5 to 2, maybe around 1.7, but the underlying performance of the business in terms of passenger unit revenue was very good and very encouraging in Q2 and the outlook for the rest of the year is for a positive unit revenue in the second half, and a positive unit revenue for the year overall. So we'll now move to your questions and I'll hand over to Andrew.

QUESTIONS AND ANSWERS

Andrew Barker

Thank you very much and we have, I think about 80 people on the conference call listening in. So what we'll do is go to the questions in the room first and then when those are finished, we'll hand over to the operator for the phone questions, and I think our host this morning, Jarrod caught my eye first with a question. Just he knows the rules, but what you do is, you pick the microphone up and press and hold the hold button and there should be a microphone in front of your seat.

Jarrod Castle - *UBS Investment Bank, Research Division - MD, Head of the Travel and Leisure Sector, and Co-Head of the Global Transport Sector Team*

It's Jarrod Castle from UBS. Just 3 if I may, any initial thoughts on Air France's announcement with their adjustment to their JV? Just kind of a quick recap how you see things with staff relations especially at BA at the moment. And then just quickly on the balance sheet a bit, just -- can you just reconfirm the CapEx number? And in principle, when you look at the balance sheet, is it a very much a year-end kind of look in terms of deciding whether or not there's going to be capital returns in terms of specials or buybacks?

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

I think it's a bit early to comment in relation to Air France-KLM. As we see it, all it really signals in the short-term is a change in the public ownership of Virgin. We've said for a long time that the ownership of Virgin really doesn't matter because it is effectively controlled by Delta and I don't see that changing. It probably represents a positive in terms of the Air France position on what the rules should be post-Brexit given that they now have some skin in the game. So we'll look at it, but in overall terms, I'd have to say generally it's a positive because it does move the consolidation agenda forward and we always believe that is a positive, and I think Air France were making that point themselves in the brief interview I saw earlier today. So we'll have a more detailed analysis of it but at this stage, I would describe it as a positive development and one that we would welcome. In terms of staff relations, there are some minor issues at British Airways, but these are issues that we will tackle. We are very focused on the future of the business and I think when you look at this industry, one of the reasons a lot of airlines have not made the progress that they require, they aren't as determined as they should be in terms of addressing the needs of the business for the future and take short-term measures while avoiding tackling the structural problems that are evident in more difficult times. We believe it's a critical issue. We are positioning our businesses for the future. I think we're very well positioned and that's reflected in the strong financial performance that we have today and a very strong operational performance. You don't get a strong operational performance without having people in the business who are committed to delivering. So I'd filter out a lot of the noise in the media and I look at the underlying issues and the underlying issues as I see them are actually quite good. On the balance sheet, our CapEx --

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Enrique Dupuy de Lome Chavarri - *International Consolidated Airlines Group, S.A. - CFO and Executive Director*

So I think we've been telling you '16 was a light CapEx year, so probably the figure for the full year would be below EUR 1.5 billion, that's below the average. '18 is going to be a little bit of a climbing up again. So we must be slightly cautious taking into account what's going to be in next year. Although the figures will show significant headroom, we will probably propose a regular dividend policy in the month of November, Capital Markets Day and maybe later on, we will talk about any other extraordinary type of decision on remuneration to shareholders, of course after the board takes a view on these circumstances, and these opportunities.

Neil Glynn - *Credit Suisse AG, Research Division - Head of the European Transport Team and Global Transport Sector Coordinator*

Neil Glynn from Credit Suisse. If I can ask 3 quick ones please. The first with respect to the transatlantic, obviously the U.S. point of sale timing has an impact second quarter into third quarter. So with transatlantic pricing flat in the second quarter, are you braced for a decline or can you do better than that into the third quarter year-on-year? Second question, other revenues were up 1% I think year-on-year, which was a dramatic slowdown from the first quarter growth rate. You're obviously investing on the cost side. So what do you think about as a reasonable run rate for the second half or how would you manage expectations on other revenue growth going forward? And then the final question with respect to Vueling. Obviously a 6% capacity cut for the third quarter. I noticed that seems to be pretty much all discontinued routes. Just interested when growth -- assuming growth does ramp-up again into next year, does that suggest your growth will be focused on densifying frequencies rather than resurrecting new routes?

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

Transatlantic is performing well as you've seen from the presentation, and the comments that Enrique gave you, if you look at the like-for-like our performance is good. We are expanding significantly particularly at Aer Lingus. Aer Lingus is a very heavy U.S. point of sale. So it's a good barometer for us in terms of how the transatlantic is performing and particularly it gives us a very good sense of activity in the United States and the Aer Lingus performance as you see from their results, given the significant capacity growth and the operating margin growth at the same time. So our view on the transatlantic actually remains positive. It is very competitive. Aer Lingus has seen a lot of additional capacity going into Dublin. I think the success of Aer Lingus on the transatlantic has obviously attracted other competitors into that market. But even with the extra capacity in the market, we see the Aer Lingus performance as being strong and therefore remain positive in terms of outlook on the transatlantic for the year. In terms of other revenues --

Enrique Dupuy de Lome Chavarri - *International Consolidated Airlines Group, S.A. - CFO and Executive Director*

Yes, on other revenues, maybe 2 different stories. On one side, Iberia third-party MRO and British Airways holidays -- we haven't highlighted this quarter because there's nothing especially relevant to show there and probably that's going to be a little bit of the pattern through the remainder of the year. So that's a very volatile type of opportunity -- business opportunity especially for Iberia and it will have to do with opportunities for getting additional third-party business through, I would say, the quarters. We don't foresee any type of big bumps or a rollercoaster type of projections in that specific area. And then we have cargo, and cargo, it has been promising, it has been encouraging. We need to see how it consolidates over the remainder of the year, but what's happening is again this I would say heavy traffic coming from East Asia into the U.S. and some of it through Heathrow. That's basically moving that revenue figure and also the contribution figure and we hope it will be remaining strong in relative terms through Q3 and Q4.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

In relation to Vueling, I think its been a fantastic performance by the new team there. We talked to you before about how they've gone about a fundamental revue of their network. I think the network that they have today is a much stronger, better quality network and that's reflected both in terms of financial and operational performance and it is interesting that Vueling's operational performance is excellent despite the fact that they are encountering just as many air traffic control restrictions this year as they did last year although we haven't seen as many air traffic control strikes, we do encounter quite a lot of air traffic control restrictions and they face significant challenges at the airport in Barcelona particularly with regard to security and immigration control. So they are fighting against the external factors that are challenging them, but they are doing a very good performance. And part of the weakness in the network last year and maybe year before, certainly last year, was the expansion of the network into thinner routes where they didn't have frequency. Therefore the quality of that expansion was clearly not good. We are very confident. In fact at the board meeting yesterday, we approved 5 additional aircraft for Vueling for next summer. That's on top of additional aircraft we had already approved. So we're very confident about their performance. They've demonstrated to us that they can deliver a good operational performance and strong financial performance and therefore they will start growing, it will be high single-digit growth next year, but as you say, it will be improving the quality of the network in a way that will sustain both their profitability and their operational performance. So good performance by the team at Vueling this year and gives us great confidence, as we've always had, but reaffirms our confidence going forward.

James Edward Brazier Hollins - *Exane BNP Paribas, Research Division - Senior Transport Analyst*

James Hollins from Exane. 3 for me please. Just on the first one, I was wondering if you were able to quantify potentially a range of unit revenues you see it for Q3. You seem to be indicating Q3 and Q4 both up, but given we're a month into it might be helpful. The second one is on the power failure and mixed fleet strikes. Has that had a material impact on bookings or none at all or somewhere in between and within that, if you could perhaps quantify the cost of the Qatar leases and the third one, just looking longer term, your 2020 cost program as you detailed at your Capital Markets Day last year, is it very much on track or perhaps like pouring a good pint of Guinness to require a bit of patience on that.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

Unit revenue, we're not breaking it out Q3 and Q4, but we'll say that at this stage second half combination of Q3, Q4 is positive and positive for the year. We have more visibility clearly around Q3 than we do around Q4. I'd be reluctant to call Q4 at this stage, but certainly we have enough visibility of the half to be confident about positive unit revenue in constant currency for the half. In terms of the disruption to British Airways, we've given you more details today, the cost impact was GBP 56 million, EUR 65 million. We've previously given you a gross cost estimate of GBP 80 million, which included a revenue impact. We estimate the revenue impact at GBP 17 million, EUR 20 million. So that's slightly below the GBP 80 million gross figure that we had given you. In terms of bookings, June was a record month for British Airways. We've not seen any impact on near-term, short-term bookings. We didn't see any disruption in the pattern, any disruption in behavior that we witnessed there. Looking beyond June, which you probably might have expected to show the issue, if there was going to be an issue, we would've seen it in June, we didn't certaintly see that and we're not seeing it in the forward booking profile that British Airways has. In terms of Qatar leases, they're done on what we call an ACMI basis, Aircraft, Crew, Maintenance, Insurance. These are standard leasing arrangements. We actually use ACMI in -- we've used it Vueling, we've used it in Aer Lingus, we've used it in British Airways. We've had I think at least 2 aircraft leased right through the summer period in BA at Heathrow last year. So it's a standard industry contract. As you would expect the rates are negotiated based on the duration of contract and supply and demand, but given our ability to lease the 9 aircraft from Qatar Airways, it reflects that they had surplus capacity available, which we were able to use. So what I would say is given that the disruption was in the quarter and in the half and the profitability in the quarter and half improved, you can see that it was not having a material financial impact on the business. The 2020 cost program, yes I think it's on track. There will be slight changes here and there, but generally it's on track. We know what we need to do. We're confident that we can do it and as I've said publicly, it's very much designed for the future. So we recognize that there will be some noise as we go through this, but everything we're doing is designed to ensure that we have a sustainable business for the future, one that we can be confident about investing in because we have very significant investment programs in all of the airlines, but in British Airways in particular and the program of change that we're going through is always difficult, but what gives me great encouragement and I think reflects on the strong management of British Airways at the moment is their operational performance is stunning. And I don't say that lightly and I've been critical of BA operational performance in the past, but their performance is the best that I've seen in the 13 years that I've been involved with British Airways and in the many years that I've been looking at it before I joined British Airways, the hard work that has been done is being reflected in a good performance and like I've said in the presentation there, if we can get punctuality right, and that is difficult. So if we can get that right, everything else starts falling into place after that. It will take a bit of time, but we're confident that we're on track and that these measures that have been taken are right for the future of the business.

Damian Brewer - *RBC Capital Markets, LLC, Research Division - Analyst*

Damian Brewer, RBC. Can I ask three please, hopefully quick. First of all, after Q1, can you update us in particular about where the NPS scores on the 4 different airlines have trended and in particular if possible can you give some granularity on what BA looked like before the end of May. Issues in the business, get a feeling for underlying trends there rather than any short-term disruption. Secondly on pensions, could you give us an update on what consideration you are giving in changing UK longevity assumptions and whether you think that will make any difference to your ultimate required payments for the pension schemes? And then very finally with Iberia, obviously stepping gently into Asia at the moment. Asia-Latin America appears to be a market with no non-stop connections, so does Iberia intend to tap that, and is it seeing any benefit from that already. Thank you.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

the trend in British Airways prior to the issue in May was positive, so it was moving in the right direction. Obviously it took a hit in May, but its returned to a positive direction again in June and July and we expect to continue that trend. I don't have the final figures for July. We recognize -- you don't go through change -- structural change for the future without having some reaction and we know, if you look at the history of other airlines who've gone through similar change to BA, it does take time. Normally people would say it takes at least 6 months and we have the benefit of having gone through it at Aer Lingus and Iberia and indeed now with our new Chief Operating Officer at British Airways who was previously at Air Canada where he went through a similar change. His view is it will take about 6 months as well. We've also had the value of giving his insight into some of the things that he thinks that maybe we could do based on his personal experience of having done similar things at Air Canada. So I think we're benefiting again from the influx of the new talent and external talent into British Airways giving a new fresh view as to what BA could be doing, but we are relaxed about this. We look at this with a long-term value of the business and we're as I said, conscious of what's going in the short-term, but we're all the time looking to where will this lead us in the long-term and we're definitely going in the right direction. On pensions, the actuarial valuation clearly will be an issue for the future. I'm not aware of any significant changes to longevity assumptions. We have as you know a very significant number of people within the pension schemes at British Airways. So there's good data on longevity specific to BA as well as the external metrics. So we'll talk about that at some stage in the future --

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Enrique Dupuy de Lome Chavarri - *International Consolidated Airlines Group, S.A. - CFO and Executive Director*

I think that will be a subject for the Capital Markets Day. We're re-thinking a lot of aspects of the whole - I would say pension fund liability battlefront and I think probably we can (inaudible).

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

And Asia, you quite rightly said, it's good for Iberia to dip its toe back into the water there. Performance has been good. We're pleased with the Asia performance for Iberia. Its still very early days, but yes, I think there is opportunity there and this opportunity based on an improving environment in Latin America and the fact that the Iberia brand had landed well in Asia. It's only on 2 routes, but again we've always argued that the Iberia brand with the halo effect of IAG has the ability to look at additional growth opportunities in Asia. So that is something that we will be looking at. We don't have any near-term plans for additional capacity into Asia. We want to consolidate on the 2 destinations that we're serving at the moment, but I think it is definitely an opportunity for the future. Oh yes, sorry, we measure the performance of both British Airways, CityFlyer, Iberia Experess, Iberia, Vueling and Aer Lingus and from memory, all of them have trended positive. One that has probably shown the most significant increase has been the Vueling one, which is actually recovering much faster than we had expected and I think that reflects the very strong operational performance of Vueling in the 6 months. So as I look at the trends -- the Vueling trends, I think the most positive family is actually at this point well ahead of our year end targets, but all of them have performed well.

Anand Dhananjay Date - *Deutsche Bank AG, Research Division - Research Analyst*

It's Anand from Deutsche Bank. Just 2 questions please. When you look at the group, at what point do you think it makes sense to split out the other revenues thinking from a cost perspective, so we can be explicit around that and then we know what the airline is doing, we know what the other revenue is doing. And then secondly, is there anything you can say in your -- presumably your latest discussions around Aer Berlin and Alitalia, do you see any chance that attractive bits fall out or do you still think it's a kind of group that's acquired, or whatever the result is?

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

I'm not an accountant I'm pleased to say. So there are accounting issues in relation to this. I think we are getting to a point where it will make sense, but I take the lead from the accountants on this particular issue. So maybe we'll talk a bit more at Capital Markets Day, but it clearly is having an impact in terms of how we report and how we're trying to split that out to give you better visibility of the underlying airline performance and we're always uncomfortable because we don't like trying to make excuses for what looks maybe like a negative figure, but it is important that you understand what the underlying performance is. So we'll do a bit more work on this and maybe I'll try and give you a better answer at Capital Markets Day in November. In relation to Air Berlin and Alitalia, what I can say to you is that we did not participate and we did not submit a non-binding expression of interest in Alitalia on Friday, which was the closing day for expression of interest. I've read in the newspapers that there were 10 parties, some newspapers said we were 1 of that. We're not. So we did not express any interest in Alitalia and I don't know who the parties are other than -- Ryanair I think is the only one that publicly disclosed the fact that they've put in a non-binding expression of interest, but we're not participating in it. In Air Berlin, Germany is a market that's clearly of interest to us and we have experience in the German market and there maybe things that are interesting to us there, but we will look at what happens with Air Berlin, and the Air Berlin Group and what Etihad does. But there's nothing that we are actively participating in at the moment, but we're more closely looking at Air Berlin and we're not looking at Alitalia at all.

Andrew Barker

No further questions from the room. So if we can hand over to the phone operator and see if we have any questions online. Last we checked, there were 67 people online including quite a few investors and analysts. So over to the phone operator.

Operator

Certainly, we can take our first question from Andrew Lobbenberg from HSBC.

Andrew Lobbenberg - *HSBC, Research Division - Head of the European Transport Team*

Could you offer us any update on what the thinking is on LEVEL in terms of establishing it as a independent corporate entity? Could you offer us any update on Iberia labor talks and the potential to expand Iberia Express if you don't get a good enough deal there? And as a third question, could you just comment on the relations between your good partner American and your good partner Qatar since that situation doesn't seem to be calming down in anyway and if anything seems to be getting worse. How can you -- how does that impact your relations with your two partners? How does it impact your business and how do you make it better?

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

On LEVEL, we're very encouraged by the performance of LEVEL. I have to be honest, it has surprised us at just how strong the booking profiles have been particularly on -- at Buenos Aires-Barcelona-Buenos Aires, Barcelona-Los Angeles and you've seen we've increased capacity between Barcelona and Buenos Aires having announced an increase from 3 flights a week to 5 flights a week and we've also agreed 3 additional aircraft for LEVEL. So we're now at the point of putting the LEVEL management team in place. I expect that to be in place, definitely in the first quarter but probably before year end. So we've approved a business plan at IAG board yesterday for LEVEL. The board is very encouraged. In fact, it's a great one when the board is pushing you to move things faster. So I think they are very encouraged by what we've seen and the opportunity that we believe exists. So we will have that established by Q1 of next year if not before year end. The Iberia labor discussions, as you know, we haven't actually started the renegotiations of the contract, but there is always ongoing dialog and a very good relationship between the management team and the trade unions at Iberia. Iberia Express, we do have scope within our existing agreements to increase capacity in Iberia Express if we want to. It's performing extremely well. It's been a real success, but the whole performance of Iberia has been great. If you look at financial results and our internal outlook in terms of the year, this will be a great year for Iberia and reflects the very significant and fundamental structural change that Iberia has gone through. And on the American and Qatar, yes, its great fun. I stand between the 2, I was actually present and standing between Doug and Akbar before Akbar mentioned to Doug about his intentions to acquire a 10% stake, that was in Cancun. I wasn't present when the discussion took place because I'd walked away and it was only when I read about it afterwards that I realized I probably missed a historic moment, but the relationship between us and American is very good and the relationship between us and Qatar is very good and we have a pragmatic approach to this and we're friends with both and if they are not friendly with one another, that's an issue for them, but it doesn't impact on how we treat American or how we treat Qatar and as I said before, its the great advantage of being Irish, everybody loves us. So we get on well with everybody.

Operator

We can now take our next question from Mark Simpson from Goodbody.

Mark A. Simpson - *Goodbody Stockbrokers, Research Division - Analyst*

Couple of questions. I think there was a comment last quarter that we might get a update on your thinking about GDS. So I wonder if you could just take us through your current sort of views on that? I don't know if Alex is on the call, but maybe one for him. Fairly robust comments recently about the sort of difference in the products at BA between kind of premium and I presume premium long haul and a more stripped down intra-EU products. So I'm just wondering if you can share some thoughts on that. And then finally just on sort of issues about cost, anything you can give us guidance about -- your thinking about ground handling at Heathrow. You've obviously had success through the third-party ground handling agreement at Gatwick, but obviously a big bucket of cost at Heathrow. Just wondering if you could give us your thinking on that?

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

In relation to the GDS, there's not a lot more I can add at this stage, but we definitely will be talking more about it at Capital Markets Day in November. So we continue to engage with the major GDSs. We're engaging from our point of view in a constructive way. As we've said publicly, we believe there is a role for them and we want to have a constructive relationship with them, but one that is different to the relationship of the past, but we will definitely talk more about that in November. So I'll have to ask you to be patient and wait until then. I think -- I don't know if Alex can speak on the line, he is here. He's just getting the microphone. What I can say is that, don't always believe what you read in the newspapers, but I'll let Alex address that.

Alex Cruz

Don't always believe what you read in newspapers. Indeed, but more than anything else, please go back to our CMD presentation last November where we specifically and very detailed laid out what the plans were for our cabin investment and there's a slide specifically dedicated and we haven't deviated from it. So beyond that, you can extrapolate any information. We spent some time talking about it. We'll continue talking about it. Tremendous amount of investment on premium and continuous investment in the rest of the cabins as well, but again, against the logic of what we explained to you at our Capital Markets Day in last November.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

And in relation to ground handling at Heathrow, I've said publicly that I think the size and scale of the ground handling operation that British Airways has at Heathrow probably does not lend itself to any form of outsourcing and therefore, what we need to do at Heathrow is ensure that our own internal operation is efficient. We've got a new management team in Heathrow doing an excellent job and again, the evidence of that is in the operational performance. So quite a bit of change going on there. It's structural change for the future and it's a change that's been done in full cooperation with the workforce at Heathrow. So I'm actually very pleased with what it is we're doing there where we're using more technology and automation to improve our performance and there is a lot more to do, but we're making good progress and it's an area of particular focus for the team under Alex. And as I've said, if you look at how we've been performing in terms of operational statistics at Heathrow, not just in terms of punctuality, but in terms of baggage performance is the best we've seen. So great credit to the team there. More work to do, but I think good progress and certainly going in the right direction.

Operator

We can now take our next question from Stephen Furlong from Davy.

Stephen Furlong - *Davy, Research Division - Transport and Logistics Analyst*

2 questions. As you mentioned already about maybe Air France now with skin in the game in terms of Brexit and ownership discussions, I just wondered, do you think that the U.K. should take a leadership role here and maybe propose whether the CAA or whoever removing ownership restrictions in this industry, which seem to be byzantine really. And the second question is, obviously Aer Lingus looks like a great success if you look at the return on invested capital and it really consolidated your leadership position on the transatlantic. I'm just wondering, do you think there is more you can do to enhance the position in Asia when you look at maybe the emphasis on your competitors have done in terms of JVs just looking again at today, for example, the China Eastern deal with Air France, that would be great.

Willie Walsh - *International Consolidated Airlines Group S.A. - CEO*

On ownership and control, I've been very vocal about ownership and control for many, many years, nothing to do with Brexit and actually nothing to do with me being employed by BA or IAG. Previously I expressed very clear views that ownership and control is ridiculous. There's no justification from what I can see to have these restrictions on ownership and control for airlines. That's a personal view that I've had for many, many years. I've expressed that openly and I'll continue to express it. I'm not going to say how the U.K. government should approach negotiations, but what I can say is that, what I've seen of U.K. politicians and U.K. civil servants, if you like in relation to this is, they have a very open attitude. I rarely, if ever hear them talk about restrictions. More often than not, if not always, they are talking about open competition, further deregulation. They have always put the consumer first and it's consumer interest well ahead of any commercial interest and I see no evidence to suggest that has changed. So if they were to take leadership on it, its certainly something that I would welcome. I don't think it would be something that would be positively responded to it in terms of other countries taking equal steps, but we'll wait and see. The Aer Lingus performance on the transatlantic is very encouraging and in terms of what we do in Asia, we're still confident that there is organic growth opportunities for the airlines, maybe not Aer Lingus in the short-term, but with Iberia definitely, with LEVEL definitely, with British Airways, yes there is opportunity there, but we think with Iberia and with LEVEL and possibly with Aer Lingus in the future, there is some further organic opportunities. Inorganic, we've always been shy about Asia principally because we don't see much profitability in that market and we think there's a lot to do before we'd be willing to look at anything, but I think the steps that we have seen with some equity participation have been interesting, but I'm not sure that they've demonstrated that its a positive thing to do at this point. So we'll continue to watch what happens in Asia, but we're not going to change our plans. We see no reason to change the plan. We'll talk more about it at Capital Markets Day, but at this point, we don't see any reason to change our approach to Asia.

Andrew Barker

I think there are no further questions on the line. So we'd like to finish it here. Thank you very much for coming and see you at Capital Markets Day in November. Thank you.