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IAG.L - Q1 2018 International Consolidated Airlines Group SA Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the IAG Quarter 1 Results Conference Call.

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

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Thank you, and good morning, everybody. Thank you for joining us on the call for our Q1 results, and I'm pleased we're reporting another strong quarter performance with an operating profit of EUR 280 million, it's up from EUR 160 million last year with improvements in all of the operating companies. And we also saw the continuation of the positive trends in unit passenger revenue at constant currency and also improved nonfuel unit costs.

We're maintaining our guidance for the year despite the significant increase in the fuel price. So at current fuel prices and exchange rates, we still expect our operating profit for 2018 to show increase year-on-year in both passenger unit revenue and nonfuel unit costs were expected to improve at constant currency. We've added a small update in relation to Norwegian to confirm that we have had contacts with the Norwegian Board regarding a possible offer, but have not reached any agreement. And as a result, we're currently considering all of our options in relation to Norwegian.

I hand over to Enrique now, who will take you through the details presentation, and then I will come back and say a few words before we take your questions. Enrique?

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Thank you, Willie. So as Willie said, our operating profit for the first quarter has been EUR 280 million, which represents a very significant improvement of the results of the same quarter last year, EUR 120 million improvement. Margin of operating profit has reached 5.6%, and these are very high margins for all of our operating companies. As a whole for the group, it represents a 2.3 percentage points increase in margin against the same figure last year.

Our capacity has been growing by 4.1%, slightly below the forecasted figure, and that's mainly because of some weather disruptions, especially in British Airways and Aer Lingus. The figure of RPKs, our demand figure has been growing by 6.1%. So a significant improvement in terms of seat factors, and it means that on our strategic markets the balance between the capacity that we're deploying and the demand is performing positively.

And of course, it's showing on our -- in passenger unit revenue figures. The figure for the quarter in constant currency terms has been an increase of 3.5%. Still we are doing some work on trying to understand how much of these improvement is related to the change in Easter holidays against last year. As you know, this year Easter holidays was more skewed towards the month of March, so first quarter. And if we take the passenger unit revenue at constant currency figure for the first 4 months, so including both March and April, and we compare it with last year's figure, the passenger unit revenue improvement would be still growing at 2.4%. So the underlying trend, apart from the positive impact of the Easter holiday different timing, is positive, still positive.

When we come to the nonfuel unit cost metrics, we have achieved a positive, so negative, so a reduction in terms of nonfuel unit costs of 0.9%. This has to do with first lesser third-party activity on our MRO Iberia business and also in British Airways holiday figures, but if we stripped that one out, the underlying nonfuel unit cost trend is also negative, so positive for the first quarter of the year, minus 0.3%.

When we get a little of an insight into Q2, these nonfuel unit cost performance is going to very probably keep on being positive, so negative. Because as you remember well, we will be rolling over the disruption that occurred in June for British Airways that created quite sizable increases in nonfuel unit cost. Also, we are -- we'll be starting since the month of April to account for the savings that we will be achieving on the new pension fund schemes for British Airways.

Of course, we have to talk also about fuel, and fuel has been a tailwind, and probably will be a tailwind further on through the year. In terms of our impact as that was seen further pages, it has been sizable in constant currency terms, around 10% unit cost increase. It has not been so important in euro terms, and that's because the dollar weakness that we are accounting for in this first quarter of the year. And that's probably something that we'll be also extending to the next months because the strength of the dollar last year was both in Q1, but also in Q2.

So if we get in through the following page, where we are recording the different sources of contribution to our improvement in operating profits from the first quarter, we are recognizing alongside a positive 4x impact, as I told you and I mentioned around the weaker dollar against Q1 last year. But of course, we are having to highlight the very significant contribution on passenger revenues. And as you see, it's not so much in volume terms, it's, of course, in price terms, EUR 156. And if we compare that one with the fuel cost negative impact, just, I would say, the sense of the -- size of the bars will be giving you an idea of how much we are recovering of the fuel cost, which is over-recovering in this specific case on the fuel cost increases.

We are also mentioning that lesser level of third-party revenues that we are accounting in basically the area of third-party MRO activity in British Airways, and that has been partially offset by, we have to mention, a stronger cargo contribution, stronger cargo performance for Q1 in respect of last year, which is a continuation of what we have seen in the previous quarters. We also have to mention as a positive contribution, the improvement on nonfuel unit cost performance. We'll be talking a little more about it in the following page.

So coming back to unit revenue performance. And here, we're bringing a chart that you're used to. You know well on one side, capacity increases and changes on the other side, unit revenue performance. And as you see in the right hand circle, we can acknowledge that revenue, unit revenue performance has been positive or very positive in all our main strategic markets. But we need to talk especially about 3 of them. On one side, North America, North Atlantic. On the other side, very positively, Latin America. And thirdly, again I mentioned on the intra-European traffics.

So starting with North America, North Atlantic performance, an increase in unit revenues of 3.8%. And as you know, I think we need to fine-tune the figure because we are investing in growth both in LEVEL and Aer Lingus. So that means opening of new routes, which will have a maturity phase until they get to full contribution. So if we were to talk just on like-for-like routes that we have been operating, the improvement in unit revenues in North Atlantic will be reaching 5.1%. So the underlying market is strong between our basic hubs and the North Atlantic destinations. British Airways is up 5%, Iberia 4%, so strong, strong performance.

But I think the best in the chart is Latin America. And Latin America, as you see, has had an improvement and increase in unit revenues of 8%, and it's both Iberia and British Airways, the 2 operation companies, have been achieving very significant improvements. Of course, we have to mention Argentina. We have to mention Brazil. And very especially we have to mention about British Airways, Santiago de Chile, which has had an excellent performance through the quarter. The Caribbean destinations have also been performing positively.

In Europe, also positive unit revenue performance, 4.3%, against a capacity increase of 6.5%. So there the balance is still working between capacity and demand. And we have to say that the whole of the group, so the 4 companies have been improving their unit revenues in Europe through this first quarter.

So less relevant, but also positive improvements in Asia Pacific, especially in the case of Iberia and Tokyo and also improvements in Africa, Middle East and South Asia. A little bit of a reference on domestic. You see that the figure in terms of unit revenue improvement is lower, it's 1.6%. It's very much influenced by Vueling, Vueling growth, especially through the Canary Islands, which, as you know, is a long route and that brings and drags down unit revenues average for the whole of the group.

So if we follow to the next page, where we have a -- a little bit an additional reference to nonfuel unit costs. The message on top of the chart is very clear. Nonfuel unit costs under control. And this is because really we have been improving our unit cost performance both on the employee side, on the supplier side and on the ownership side.

And if I have to summarize the underlying reasons why, it has to do with, what we call, efficient growth, but probably the best way to summarize efficient growth is how we've been performing in terms of employee productivity. So the level of average manpower through the period, first quarter against last year, has remained basically flat and the capacity has been growing by 4.1%. So productivity has been improving more than 4%.

Also to mention ownership cost improvements. This is a combination of better utilization, especially at Vueling also Aer Lingus and also we've been able to reduce the asset value of the assets, of some of the assets that we are working with, in especially in Iberia, the case is for the A340-600, which we have been operating in the past on a lease base. But as we have -- as we have asset value guarantees on those aircrafts, we've been able to repurchase them to operate them at a very low ownership cost.

So if we follow through the fuel chart it's there where we basically are recognizing the impact of what we have seen in the market in the last couple of weeks. So we have been seeing market fuel prices increasing to a level of $700 per metric ton of kerosene, probably that's part of that increase that has to do with temporary tensions and political type of turmoil around some of the countries, some of the producers, but there may be also underlying strength in that market. So we are referencing our figures to the $700 per metric ton. And on that type of reference and using a dollar-euro rate of 1.21, fuel bill will be growing to EUR 5.4 billion, which is an EUR 800 million increase over last year. Of course, part of that increase has to do with growth, with the EUR 7.8 growth in terms of ASKs that we'll be producing this year against last year.

So getting into the ROIC page. Again, it's very significant improvements against last year and against the figures that we disclosed by the end of February. We have to be, I would say, transparent enough, recognizing that as we are using the 4 last quarters, we are probably over-recognizing a little bit Easter holidays because this year was mainly March and last year was split between March and April. So after saying that, the figures and the improvements that we are accounting for and recognizing are very significant. As a group operating margin, Q1 '18 has been 6.9%, again a very significant figure, 2.2 percentage points above last year. It represents in terms of ROIC of the last 4 quarters a 16.7% figure. And as you know improvements are across the board. In the case of Aer Lingus, very relevant, and this is mainly related to Easter holiday impact in Aer Lingus in the year 2018.

So as you see operating margin has been improving by 11 percentage points. And it, operating profit for the month, for the quarter, has been quasi breakeven, which is a very positive figure for Aer Lingus in this seasonal, low seasonal first quarter.

For Iberia, there's also improvement in margin, 2.4 percentage points and ROIC has been reaching 13.2%. For British Airways, operating margin Q1 has been 9.9%. And I make a little bit of stop here because those types of levels were the ones that British Airways were considering for average full year targets, just maybe 8 years ago. So achieving these margins in the first quarter is very relevant. And for Vueling, also an improvement of 3.3 percentage points and ROIC last 4 quarters, 13.6%.

So a little bit of a snapshot on our basic financial position and balance sheet metrics. So gross debt since March last year has been reduced by EUR 1.3 billion, and that's basically having to do with regular repayment of our balance sheet debt.

Cash and cash equivalents since March has been basically kept at the EUR 7.5 billion level. We have to consider here that the figure of March year 2017 was very positively affected by Easter holiday. So it was, including the sales, most of the sales cashed in for the Easter holidays, but of course, not the cost of the travel because the cost of the travel were basically accounted for in the month of April. So the EUR 7.4 is, again, a very high figure for March in 2018, and it reflects an on balance sheet net debt, which is negative, so cash-positive by nearly EUR 500 million.

Aircraft lease capitalization has been gradually increasing, reflecting the increased number of leases in our fleet structure. But even accounting for those, adjusted net debt has been reduced by EUR 500 million. And so the adjusted net debt to EBITDAR figure has been coming down from the 1.5x to 1.2x. That has been recognized also by rating agencies and Standard & Poor's has been the final one to attribute British Airways with an investment grade rating for their debt.

So finally, a little bit of a review, which you already know about on the consequences, positive consequences of the new pension fund schemes that British Airways team has been able to agree with unions and pension fund trustees. On, I would say, a very positive outcome for the company and also for the group. So as you know, the NAPS scheme has been closed for future accruals, the BARP scheme has been closed for future contributions since the 31st of March of '18. And these would be representing not only improvements both from the point of view of the balance sheet and also from the profit and loss account. But it would mean a much less -- much lower level of volatility and exposure for British Airways and the group to changes in interest rates, inflation, et cetera. So a quick reminder of the figures. We'll show that on the income statement one-off net exceptional gains will be -- have already been improving figures by EUR 678 million, and this will have an impact in our income statement for the rest of the year of GBP 60 million from Q2 and into Q4.

In terms of our balance sheet, the pension fund liabilities will fall by EUR 872 million. And as transition cash arrangements for the beneficiaries of the funds, of the pension funds we've been allowing cash transition payments of EUR 192 million. As you know the tri-annual revision of the pension fund deficit has only started by the end of March, I'll -- and we'll be taking some quarters. There is a deadline for finalization, which is end of June next year. But we hope that these agreements, these initiatives will result, as I told you, in probably lower figures and assure a much lower level of vulnerability.

And now I'll bring back the word to Willie.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Thank you, Enrique. So just to reaffirm, our guidance for the year remains unchanged. And at current fuel prices and exchange rates, we still expect operating profit for 2018 to show an increase year-on-year. And both passenger units revenue and nonfuel unit revenue costs are expected to improve at constant currency.

And finally, before I take your questions, just to give you a snapshot of our capacity plans, which remained broadly unchanged, some minor changes between Q2 and Q3, we will be reviewing Q4 capacity in the coming weeks, and I'd expect to trim that figure down. But the capacity plans that we have are perfectly justified by the returns that we're generating and by the demand that we're witnessing in the markets.

So with that, I'll hand back to the operator, and we'll start talking -- taking your calls.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll now take our first question from Daniel Roeska of Sanford Bernstein.

Daniel Roeska - *Sanford Bernstein - Analyst*

Three questions, if I may. Maybe, Willie, just -- could you expand a little bit on your last capacity comment. Looking towards Q4, turning that -- could you talk a little bit about how you see the sector in 2019 as fuel prices remain high, how you would think about your capacity deployment next financial year. And secondly, on Brexit, just a short follow-up question. Any update on ownership structures for Aer Lingus or Iberia in that context? And any update on the U.S., U.K. OpenSkies progress? And lastly, I'll touch on consolidation, outside of Norwegian. If we exclude that for just a second, with higher fuel prices, more consolidation may be likely, what would you be looking for in terms of a target in the European market? So what criteria would you be looking for, if you were thinking about acquisition in the European space in more general terms?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Thank you. In relation to capacity, we keep that under a constant review. And we're very pleased with the capacity that we're witnessing from the industry. As Enrique said in the presentation, the Q1 results clearly demonstrate the capacity that we put in was very much below what the demand was in the quarter, and we believe that, that's going to continue through the year. But obviously with the higher fuel price, we would expect some people to trim back Q4 capacity, and we'll be looking to do the same, and we'll have a view on '19, year 2019 later on. On Brexit, as you know, we've not made any changes to the Iberia structure, that's been in place for some time. In relation to Aer Lingus, we didn't put an ownership control structure similar to BA and Iberia in place but we have one ready to put in place, if necessary, and we will continue to monitor that situation. And on the discussions between the U.K. and the U.S., I've had regular dialogue with the Secretary of State, Chris Grayling, who remains confident and I share his confidence in relation to that issue. He's reported good and constructive dialogue with his counterparts in the U.S. And you've seen our comment in relation to Norwegian, we have had some contact with the Board. I understand -- we haven't seen it yet, but I understand Norwegian has issued a statement to confirm that contact didn't go anywhere, and we'll have a look at all of our options in relation to Norwegian, but we're not actively looking at anything else. What we do expect to see, and I think a number of people have said this, is some of the weak carriers are clearly looking even weaker with the fuel price where it is. I suspect the challenges that they face are just going to increase. And so I wouldn't be surprised to see a few of these weaker carriers slip further into difficulties and potentially see some exits from the markets in the later part of this year. But we're not actively pursuing any other issues, and we're not considering anything. And as I've said already, we're going to consider all of our options now in relation to Norwegian given that the initial contact we've had with them has not led to any agreement.

Operator

We'll take our next question from Savi Syth of Raymond James.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

I'll limit to 2 questions here. Just one, could you just remind me your greatest (inaudible) exposure from a corporate and business standpoint? And what trends you're seeing on that as you look ahead from a travel standpoint? And then secondly, I know Vueling's been kind of focusing on growing in Italy, but with Qatar being a big investment of Air Italy, I was just wondering if there was any -- a meaningful opportunity for any of the IAG brands to partner with Air Italy?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay. Thank you. On corporate and business activity, the demand remains good in pretty much all segments, and we monitor the BA activity very closely. And the performance in the first quarter and the forward bookings that we have are good. We're not seeing any areas of concern. Some areas stronger than others, but in general, it's a healthy outlook. In relation to Italy, yes, Vueling will continue to look at opportunities to grow organically there, and those opportunities, I think, are increasing with the ongoing challenges faced by Alitalia. We're pleased to see the commission consider again the state aid that was made available to Alitalia. We have objected to that. We don't believe that, that's appropriate, and we will keep that situation under review. If Air Italy is looking for some interline or code share or transfer, we're happy to do that. So we've already demonstrated that it's something we can do and will do where we see opportunities to work with other partners. So it has absolutely nothing to do with the shareholders in IAG or in any other airline as we've commented on before in relation to Aer Lingus we've been pleased to have successful dialogue with Ryanair about transfer passengers at Dublin Airport from Ryanair onto the Aer Lingus transatlantic services. So where it makes sense from a consumer point of view, we're happy to put arrangements in place to facilitate consumers who want to transfer between airlines, and that's regardless of the ownership issue.

Savanthi Nipunika Syth - *Raymond James & Associates, Inc., Research Division - Airlines Analyst*

If I may follow-up just on the corporate level, what was -- or actually maybe premium versus economy. Could you kind of elaborate what the trends were in the quarter?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

No. No, we don't do that, but you can see it was a strong quarter. But as I said, all of the corporate activity has been good, and the outlook that we have for corporate activity remains good.

Operator

We'll take our next question from Stephen Furlong of Davy.

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

Just 2 questions for me, and just on the guidance. I mean, the guidance is the guidance, and I was just wondering, last year you talked about specifically at the state of Q2, and why you haven't done that this year? Is it just because the environment hasn't really changed, maybe you're expecting with fuel there being an acceleration or improvements in the peak summer? And secondly on costs, which were very good in Q1. And I know you've guided down for the year, just as you did at the full year. Were you surprised that they were kind of benefiting faster because I thought of this -- I got the impression it was going to be Q1 maybe slightly up and then down for the rest of the year, so maybe just phasing.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Thanks, Stephen. Yes, as you said, the guidance is the guidance. I think in Q2 of last year, we just started seeing trends that we wanted to highlight, and that's why we specifically made an additional reference at Q2. But I don't have anything to add other than, I think, it is positive that we're saying with the significant increase in the oil price, we continue to hold our guidance and expect our operating profits to improve during the year. And on costs, I think Q1 performance was better than planned. And I think a credit to all of the airlines for that. We've been clear, we have a long-term goal in relation to nonfuel unit cost. It's not going to be an even achievement through the quarters and through the years, but we're very confident that, that longer-term goal of reducing by 1% per annum on average over the period is a goal that we will achieve. But there's a good focus in all of the airlines, and you should expect to see that continue through the year. But then it's not going to be a -- an even achievement through each of the quarters during 2018.

Operator

We'll take our next question is from Neil Glynn of Crédit Suisse.

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

If I could ask 3 quick ones, please. Enrique, you mentioned the productivity strength of performance in the first quarter, which I've noticed. Employees were flat year-on-year in the first quarter driving that. Just interested, can you hold this? Can you hold employees flat for the rest of the year? Or how do you think about headcount developments as the business grows? Then the second question, into the second quarter, I guess the second quarter should be helped by the U.S. point-of-sale given the seasonality of the business. Just interested, to what extent Q3 might be, in any way vulnerable given a greater reliance on U.K. and Europe, given I think the U.S. might be a stronger point-of-sale right now? And then finally, can you confirm if a transaction proceeds, will the buyback currently planned be influenced in any way by that?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Let me deal with the last question and then I'll hand over to Enrique to comment on the others. Our intention continues with the stated objective to do a buyback of EUR 500 million regardless. So it's not going to influence whether we don't proceed with Norwegian. That would a -- it is why I included it in the bullet point. I didn't specifically make reference to it in my opening remarks. But just to reaffirm that it is our intention to do that buyback this year. And Enrique?

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Yes. Yes, productivity, you can expect to see increases for the full year and significant increases. You have to take into account that we are planning for a capacity increase of 6.8%, and that will allow the core operating companies to manage efficiently their workforces. So the number of employees is not going to be remaining flat, but you are going to be seeing sizable improvements in productivity through the year.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

And on Q2 and Q3, we're not expecting or seeing or anticipating any changes to the behavior in terms of booking profiles, so we haven't seen any changes. And the forward-booking activity that we have in Q2 is in line with what we would have expected. And obviously, with less visibility into Q3, but what we do have is not showing any signs of change. So I don't think we'll see change in the sort of normal patterns that you would expect in Q2 and Q3.

Operator

We'll take our next question from Jarrod Castle of UBS.

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

Just in coming back quickly, I've got 3. One on cost control, if you could give some color in terms of the operating units? I mean, is the bulk of it coming from BA? Or is it equally split? Secondly, just on Page 10, in which unit would level be currently based on that slide? And as and when will you start to split it out? And then just lastly, IFRS 16, I don't think you're kind of adjusting for it yet, but can you give an idea, at this point, what it would mean for balance sheet? And obviously, when you're talking about operating profits, the adjustments there?

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Yes. In terms of cost control, yes, and nonfuel unit cost performance, it has been positive for all the airlines. Of course, with some special tailwinds for airlines that have been growing faster through the quarter. So especially Aer Lingus, Vueling and Iberia. So that's basically something that will be continuing through the following quarters. If I jump to IFRS 16, we are still on the process of reevaluating its impact in our accounts. The early findings that we are reaching is the impact is not going to be sizable, both in terms of liabilities and in terms of operating profit. Of course, operating profit would be closer to the one that we have been calling adjusted operating profit, just to reflect that type of difference. But as a whole, what we're seeing is impact is going to be low or moderated.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

And in relation to Page 10, LEVEL doesn't appear in that. So you see it in the IAG figure, but it's been stripped out of the Iberia figure. So it will in due course, you will have more visibility around it. But it's a small entity at the moment, growing this year. But its performance is reflected in the IAG, but not in any of the other OpCos.

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

And so just related to LEVEL, whether or not you do Norwegian, does that have any impact in terms of your growth plans for LEVEL, can you say?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

What I can say is that we approved at the IAG Board the acquisition of 2 additional aircraft for LEVEL yesterday, and we're continuing to look at options for LEVEL's growth. So we're not in any way changing or delaying or slowing down. We continue to look for opportunities, but we are continuing to see good opportunities for LEVEL and are looking at additional European cities. The performance out of Barcelona is very positive, particularly, as I've said before, into Buenos Aires and we've added capacity in there and the performance that we're witnessing in terms of advance bookings out of Paris is also very positive. So we're not changing our approach to LEVEL.

Operator

We'll take our next question from Andrew Lobbenberg of HSBC.

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

Can I ask about some of the aircraft types that are delivering some challenges. So the NEOs that have been delivered with a bit of delay, I think, to most participants in the industry, to what extent is that affecting you, and how are you addressing that? Then on the 787s and the air engine issues on them, how is that affecting you? Are you affected by the ETOPS issues? And I think there's some stuff on the wires yesterday about Qatar perhaps helping you. And then finally, can you talk about the industrial relation situation at Vueling, where SEPLA are taking some industrial action, though it's not having too much operating impact? How quickly do you expect to close that out? To what extent are you concerned that, that drags into the summer? Does it impact bookings? Does it impact the unit costs?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay on NEOs. We're clearly very disappointed with the performance of Airbus, and I've made my disappointment known to them directly. They understand the frustration that we're experiencing. It's not impacting on our plans because we have flexibility within the existing fleet. So we're looking at covering NEO delays with existing CEOs and some options for extensions on CEOs, but I prefer not to do that. But it hasn't -- as yet had a major impact. It's causing our teams to have to work a lot harder in rejigging their schedules. It clearly is not as attractive to operate with the CEO

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as is within NEO, particularly in the current fuel price environment. So it's a very frustrating position for all airlines to be in, who are dependent on Airbus to deliver these aircraft, but we are having discussions, ongoing discussions with Airbus in relation to these issues. On the 787s, yes, we've had some impact. We expect those impacts will be increasing as we go through May, June and July, and we hope that it will be fully resolved in August or by the end of July going into August. So we're able to rejig our schedule to some degree to cover off the ETOPS issue. So that hasn't been a particular problem for us, but clearly the availability of the 787s Rolls powered 787s and it's impacting, as you know, in pretty much all of Rolls powered 787s. We'll see us with a number of 787s unavailable through that May, June, July period. We are in discussion with a number of carriers, which includes Qatar. They've been very flexible and helping us with regard to lift. It will be subject to approvals from the regulatory authorities, so we've not concluded anything, but Qatar have indicated that they should be able to assist us with additional aircraft, if required. And on Vueling, yes, I'm not concerned about this at all. I think it's -- it will be resolved when it will be resolved. It's not having an impact on bookings. The team at Vueling are managing the disruption extremely well. And they're clear, they're prepared to have negotiations on sensible issues. But on other demands, there's no way that they or we will cede to some of the demands that the trade union has made. We recognize that there are some pay-related issues that we need to address and want to address, and we're happy to have that dialogue with them. So it's not an issue of concern, it's -- actually isn't on the IAG management committee agenda, so it's being dealt with by Javier and the team at Vueling and I think it's been dealt with extremely well. So we've left it to him to address, and I'm confident that he will handle the situation. And his performance and the performance of his team has been excellent, so it's not an issue of concern to us.

Operator

We'll take our next question from Damian Brewer of Royal Bank of Canada.

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

Three questions. First of all, just looking particularly at that RASK differential between Aer Lingus, LEVEL and the North Atlantic. When you look at the business as a whole, could you give us some idea of what the mix as sort of relatively immature routes was in Q1 and what that will look like in Q2 and Q3? Secondly, on the Frequent Flyer program, you've indicated back in November at the Capital Markets Day and again after the Q4 report, there were changes in the offing. Could you give us some idea of when those might be -- we might get more on those? Whether you're still thinking of this as a dynamic pricing approach you've thought of in the past? And very finally on capital allocation, I know you highlighted the NEO issues but it appears Airbus seems to have issues with a dearth of A330 orders, is that having any influence on the way you're thinking about capital allocation and the next growth step for LEVEL?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

We don't give a breakdown of the various routes. But just to say on Aer Lingus and LEVEL, the important point that sometimes missed -- clearly not missed by you, but missed by some people, is that although they operate as a lower unit revenue, they're operating at a significantly lower unit of cost, and that's the model. You've seen the presentations from Stephen Kavanagh on this virtuous cycle that he talks about the value carrier model, which is driven off a continuing reduction in his unit cost, which enables him to be more price competitive and it's proven to be very successful. And you can see the performance of Aer Lingus in terms of their ROIC in the first quarter. On Avios and frequent flyer, you're seeing -- you've seen some changes already. The Avios Travel Reward Programme has been closed and the people in that have been migrated into the BA Executive Club. So you're beginning to see some of the changes that we had envisaged coming to reality. There's a lot of work going on behind the scenes, and we will give a further update on that. But that's the first sort of noticeable change that you should have seen in relation to Avios. And on capital allocation, I'm pleased to say we haven't changed our view. We're still -- we're taking advantage of some specific niche opportunities that are available to IAG and may not be available to others. And that's, I think, a feature of the -- that the aircraft types that we have in our fleet and the flexibility that we have within the operating companies to access aircraft both new and second hand at very attractive pricing. And we're very flexible in terms of the aircraft models that we will consider for LEVEL and indeed for the airlines within the group. So I think there's some unique opportunities open to us, and we will be disclosing some of that in the near future. But we continue to be in dialogue with Boeing and Airbus on wide-body aircraft and very constructive dialogue with Boeing, and we'll be meeting them again in the coming days actually to continue to progress that, but we found them at Boeing to be particularly constructive in the dialogue that we've been having with them of late. And that also applies to the engine manufacturers. We've had some very good dialogue with GE, both in relation to wide-body and narrow-body engines.

So it's clearly frustrating that we see some delays in these programs, but I have to say on the other hand, we are seeing some opportunities that we're taking advantage of and you should expect that to continue through this year.

Operator

We'll take our next question from Anand Date of Deutsche Bank.

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

I just had a quick one on BA management. Clearly, getting the pension stuff sorted is a very big tick and that's been occupying a lot of their time. At the IAG Board, what are you now charging them with? Obviously, there's a lot of cost that has to come out and they've got the program, but is there anything else in particular that you would now ask them to focus on?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Thank you. I'm not going to let them speak, but Alex and Steve are actually sitting here at the table. You can hear the laughter and the apprehension as they wait to hear my answer. No, at the IAG Board, we're very pleased with the progress that has been made in relation to the pension issue. We know we still have issues to manage in relation to that. There is still a significant deficit that needs to be addressed, but I think the progress in recent months has been a significant milestone and a very positive one. They are tasked with continuing to make progress, particularly in areas like their cost base, but also in terms of operational performance and customer satisfaction. And they're doing an extremely good job on both of those. So our Q1 performance in terms of punctuality was very, very good, the -- and that's despite the sort of challenges they face with the aircraft issues. And the Net Promoter Score performance continues to improve. So they're doing what we want them to do, and we expect that to continue through the year and I think the guys are now breathing again. So I'll leave it at that.

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

Can I -- actually, can I ask a follow-up as well? It's IAG LEVEL. With the introduction of kind of hand baggage-only fares on the transatlantic and the U.S. guys going down the basic economy route, does that mean that the antitrust JV needs to be renegotiated at all? Or does it just slot in, in exactly the same way as it always has in the past, i.e. do product changes, I mean, you have to negotiate the structure or not?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

No, it doesn't because it's a metal neutral approach. So it's -- these issues apply across the JV. We clearly have dialogue with the regulators in relation to bringing Aer Lingus into the joint business, so that's a separate dialogue, not in any way impacted by changes in the model. And as you know, the introduction of these basic fares or hand baggage-only are designed to give more choice, and that's exactly what we see. So we see people are choosing these fares, and then many of them decide to take advantage of the additional purchase opportunity. So I think it's a positive feature for consumers and it's generally very welcomed by consumer groups and by competition regulators. So I don't see it having any impact.

Operator

We'll take our next question from Mark Simpson of Goodbody.

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

Just a few, small, tidy-up questions. On the other revenue line, just wanted to confirm that's down to Iberia's MRO activities rather than anything else? On the BA trimming of the FY '18 growth forecast, any regional bias to that? LEVEL, obviously one thing that's surprised you on the launch was the extent of the ancillary spend you're seeing per pax, has that leveled out in any way? Is that still growing as you begin to understand that product better? So just wondering if you could talk about that. And then a final quick question, just want to clarify, on the dividend, sort of 25% payout policy and given the size of the exceptional items this year, is that on a clean basis or reported basis?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay. On the other revenue, yes, you're absolutely right. It's Iberia MRO.

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Third-party revenues. Yes, and that's the sole matter of difference between this year and last year.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

On BA, no, there's regional bias in relation to any of the capacity changes that BA has made. On LEVEL, the -- yes, we're continuing to see very good performance in terms of the ancillary revenue. In fact, the LEVEL performance, financial performance out of Barcelona has been very encouraging. There's still work for us to do there to fully exploit that model, but what we've seen so far is very encouraging and it is ahead of plan. And we're applying some of the learnings that we see on LEVEL to the other operating companies, which is helpful as well. And on the dividend, what we say on dividend, it's the underlying profit after tax. So clearly, the -- these extra -- exceptional items don't interfere with that. So we said it's the underlying profit after tax.

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Yes, and you have to take into consideration that these improvements, both in balance sheet and the income statement, are not so much cash-related. They are noncash-related. So...

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

So more like likely to influence sort of decisions about buybacks at a later stage in a sense of your balance sheet strength?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Yes. We'll consider all of these issues at the appropriate time, but we're not making any change. And that's why I just wanted to reaffirm that we have that intention to do the EUR 500 million buyback this year.

Operator

We'll take our next question from James Hollins of Exane.

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

Three from me, please. The first one just on whether you'll be seeking compensation from Rolls-Royce on those Trent issues on the 787 and maybe just discuss whether effectively this whole process with the Airbus 320s as well will cost you money, whether it should be net neutral, obviously ex operational rejigging? The second one, do you think Q2 constant currency RASK will be up or will Easter mean it's not? And the third one, Willie, if you can keep this to a yes-or-no answer, because obviously we're all keen to get ready for the big Seagulls V Man United game later. Can Norwegian execute its current growth program as a standalone business?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay. On compensation, we're definitely going to be pursuing compensation from Rolls-Royce. We're very frustrated by their performance. I've made that absolutely clear, so there's no question at their performance. It's unacceptable. And we want them and expect them to do a better job, but we are pursuing them for compensation. The same applies with any of these deliveries. So we do have contractual terms, which cover some of this, but in some cases we're going beyond what's in the contract, and we expect the suppliers to respond to our demands because, clearly, they've got to factor in the ongoing relationship that they want to have with us, and we do have options and we're going to exploit those options and deal with alternative suppliers if we don't get the response that we expect. On Q2, we don't break it down. But obviously, Easter does have an impact, and that's why Enrique sort of gave you the outlook and the performance over the first 4 months. So you can see that there is big Easter impact in March and some Easter impact in April. But if you want to look at the first 4 months, it's been a positive trend. But we're not going to give you sort of a quarter-by-quarter RASK performance.

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Although the first half will be positive.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Yes. And on the third question, I have to give a yes-or-no answer. You better ask the question again then.

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

Can Norwegian execute its current growth program as a standalone business?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

No.

Operator

We'll now take our next question from Johannes Braun of MainFirst Bank.

Johannes Braun - *MainFirst Bank AG, Research Division - Director*

I have 3 questions, if I may. Firstly on -- we had a lot of one-off costs in the last couple of quarters. Just can you confirm that the Q1 results are free of any -- those one-offs? And also in terms of the Q2 cost performance, what will be the impact of the IT outage not reoccurring in Q2 in terms of year-over-year unit cost? Secondly, I understand that the Spanish route charges will decline by 12% next year. Just trying to understand how significant that will be for Iberia and Vueling for the 2019 budget? And then lastly, any new thoughts on what can be done in Vienna organically after the NIKI deal did not happen?

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Yes. On the one-offs, every quarter has a lot of noncomparable issues affecting their cost performance. In general terms, they offset each other. This quarter, we have had disruption in terms of weather, so we have had some abnormal level of passenger compensation and disturbance in terms of our operations, but it hasn't been affecting materially the cost levels of the quarter. The only one to reference, as we said, is the lower MRO activity for third-parties in the case of Iberia against the same quarter in last year. Next quarter, as I advise you, we're going to have a couple of new issues. One is we'll be rolling over the disruption cost that British Airways suffered in June '17, the other one is we'll be starting to account differently for the pension fund obligation because of the new agreements that we have in place, and that's something that you will be seeing in the full quarter results by the end of July.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

But all of those were in our plan for the year, so this -- there's no -- nothing additional in that. And on Vienna, yes, we are looking at opportunities at Vienna. And we're continuing to actively pursue that. We see a number of slots have become available following the acquisition of NIKI by others, and they have returned a significant number of slots to the slot pool. We are looking to take advantage of -- I don't know why they returned them, probably they haven't been able to operate them. But there are slots there that we think are attractive and, therefore, we are continuing to look at an organic opportunity at Vienna. We see that as an attractive market, and we may or may not do something soon, but we're certainly looking at that as an opportunity. And sorry, in relation to Spanish charges 2019, we'll be looking at that later. My experience there is, these charges decreased in one place and increased somewhere else, so the net results never realizes in a reduction. So they look interesting headlines but I've yet to see any significant benefit from them. But clearly, that's something we will be looking at in terms of the Vueling and Iberia cost base in 2019. We've not had a detailed analysis of that. We've had a high-level analysis, not a detailed analysis, and we'll be doing that in the coming months. We normally do that in July and August.

Operator

We'll take our next question from Sathish Sivakumar of Bank of America Merrill Lynch.

Sathish Babu Sivakumar - *BofA Merrill Lynch, Research Division - Quantitative Strategist*

Couple of questions. Where do you see year-on-year trends around yield and forward booking for next few months? And secondly, on the FX side, what will be the full year FX impact at the current spot rates?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay. We don't give guidance in terms of yield, but just let me repeat what I said earlier. The current trading performance is good. We see good underlying demands in all segments. The premium or business corporate activity remains good as does the leisure activity, and that's -- at all points of sale, we're not seeing anything that is causing us concern or surprise in any parts of the network at the moment. So I would say that our general commercial outlook remains encouraging for 2018. But obviously, we've got very limited visibility into the fourth quarter. And then as I said earlier today, we have good visibility on second quarter and some visibility on third, but we don't, really at this stage, have any real visibility on fourth quarter.

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

On the Forex front, it's going to depend on the dollar behavior and the Sterling behavior, as you can imagine. So at this levels of dollar-euro rate, we expect to have probably a moderately positive impact in terms of transaction net impact. We may be having a moderately negative impact in terms of translation. As a whole, they are going to be more or less compensating each other. If we can expect a net at this moment in time, which is very early in the year, could be a net positive, moderate net positive impact.

Operator

(Operator Instructions) We will now take a follow-up question from Anand Date of Deutsche Bank.

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

There's one I forgot to ask as well. It might not be so much a Q1 question, but on LEVEL, I think you said in the past that 90% of the bookings are from brand-new customers to you, there's no cannibalization of Iberia long haul. So I just wanted to check that, A, that's still the case? And then secondly, I'm just trying to figure out, do you guys see this as just a nascent, new market that you're opening up? Or do you think there's potentially substitution from people taking their city breaks short haul or anything like that? So is it just incremental pure demand or is it coming from somewhere, not necessarily your businesses but somewhere else?

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Yes. Very good question. The situation we see is the same as before, we're not seeing any cannibalization. In fact, that has surprised us, but there's absolutely no evidence of cannibalization. It's clearly something we'll be looking at now in greater detail as we expand out of Paris, but even with the expansion that we've seen in Barcelona, there's nothing there that indicates since. In fact, Buenos Aires...

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

One of the main performing routes for Iberia in this quarter in South America had been Buenos Aires, at the same time and with similar levels of RASK improvement, the one's -- that's the LEVEL is achieving. So no sign at all of contamination in this respect.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

And I think our -- the evidence we have so far is that this was underlying demand that wasn't being served. So that there was a clear demand for this service, if the price was right. But I think there is some substitution from short haul to long haul. We're not seeing it any bookings that we have, but I think when we look at the customer profile and we do some of the research with the customers, I think they have been influenced by the opportunity to take a short break to a destination that they wouldn't have looked at previously. But in the main, this is stimulating whole new markets and that's why we remain very encouraged by the performance of LEVEL and the reason we're continuing to look at the growth and possibly accelerate the growth of LEVEL in the current environment.

Operator

We'll now take a follow-up question from Neil Glynn of Crédit Suisse.

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

I just wanted to make sure we're all on the same page with respect to CapEx expectations for 2018. Enrique, would it be possible to confirm the gross number for this year as you currently see it?

Enrique Dupuy de Lôme Chávarri - *International Consolidated Airlines Group, S.A. - CFO & Executive Director*

Yes. I see no major changes with the exception of the impact -- the unplanned impact, we don't know yet how much about the deferrals in the delivery, final delivery dates of NEOs. But in principle it's a [gross] (corrected by company after the call) figure of around EUR 2.8 billion for '18 as we planned.

Operator

As there are no further questions, I'd like to turn the conference back to your host for any additional or closing remarks.

William Matthew Walsh - *International Consolidated Airlines Group, S.A. - CEO & Executive Director*

Okay. Thank you very much. As I said at the beginning, it's a strong performance in the first quarter. We're pleased with the performance of all of the companies within the group and pleased to be able to maintain our guidance for the year. And obviously, if there are any developments on any of the issues, we will disclose that as and when required, but I'm not expecting or anticipating any announcements in the weeks ahead.

So thank you very much, and look forward to talking to you at our next call.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect.
