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

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PRESENTATION

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

Good morning, ladies and gentlemen. I'm very happy to welcome you to this IAG Second Half Results Presentation. I share with you that the board is very pleased and very happy with the management for the strong result of the -- both second quarter and the first half of the year.

IAG is one of the only few airlines worldwide to report an improved operating profit compared with the year ago. While most of our peers has been reporting decline in the operating profit, IAG is reporting an increase to EUR 1.1 billion from EUR 950 million in the first half of 2017, demonstrating our commitment to increasing shareholder return.

On the back of strong profitability, we commenced our second EUR 500 million buy back set in the month of May. We are already more than halfway through. And I'm pleased to announce as well the election in the last AGM in June of a new board member, her name is Deborah Kerr, who brings a very valuable technology skills as well as a knowledge of the airline industry, has been a (inaudible) today in the U.S. business [inaudible] and U.S. experience.

I thank you all for coming, and I hand over to [Willie].

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

Thank you, Antonio, and good morning, everyone. So I'm pleased to say, as the Chairman has said, we're making good progress. Good set of results for the quarter and for the first half. And we're delighted to stick to our guidance, which we'll talk about later on, despite the ongoing challenge of the higher fuel price, which was EUR 151 million up in the quarter.

We're also making good set of progress against our strategic objectives. We launched LEVEL out of Paris on the 2nd of July, currently flying to Montreal and Guadeloupe. Later on, we'll increase flights to those destinations and add Martinique and New York. We also launched LEVEL short haul out of Vienna on the 17th of July. So we will have 4 A321 based in Vienna this year operating a network of 14 destinations from Vienna. We're very pleased with the performance of both of those new initiatives, where our forward sales are tracking ahead of our plan.

We announced also the appointment of the first LEVEL CEO. We ran the airline for a year without a CEO and it was very successful, so let's see what happens in the second year. But no pressure on our new colleague to get up to speed by the Capital Markets Day.

And we continue to invest in the products (inaudible) about. This is going to be feature of our business for both at Iberia and British Airways with (inaudible) products, particularly in the premium cabin and with the addition of (inaudible) the A330 in Iberia.

We're growing on our networks, and 10% growth in ASK on the transatlantic in the second quarter. Half of that was on new routes, which are performing incredibly well. Nashville, was absolutely stunning in terms of its performance. British Airways launched in Philadelphia and Seattle, and are already looking at plans to increase Seattle to a daily service.

And Iberia launched its new service to San Francisco. Barcelona (inaudible) with LEVEL switched from San Francisco (inaudible) strongly as well. But we're also adding capacity in Latin America, the economies there are rising. We obviously see the uptick in the Brazilian economy. And significantly, expansion in Gatwick through the acquisition of the Monarch slots, with 15% growth there. And Vueling has done quite a bit on its network.

The common platform is proving to be very effective. There's been a good performance on our control of the nonfuel unit cost in the half. And in the quarter in particular, good performance. We're now down 11.7% versus our cost base since 2011 when we formed IAG. We're adding new aircraft, which are fuel-efficient and will give us increasing benefits going forward. Very pleased with the rollout of our new distribution model. That's been better than expected. So all in all, progress on all of the key strategic issues for the group.

And in terms of the financial performance, and Enrique is going to take you through a detailed presentation. But you can see our financial targets are all either being exceeded or -- at the half year point, with the -- well within range in terms of the full year performance, with RoIC in the half year, trailing 12 months based, at 16.2%, very good performance too. So I'm pleased with what we've achieved so far. We're very optimistic about the second half of the year, continuing optimism in (inaudible).

I'll hand it over to Enrique now, who will take you through the detailed presentation for the quarter.

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

Thank you, Willie. Good morning, everybody. Again, restating what has already been said, we've been making in this quarter EUR 803 million of operating profit before exceptionals, and this is a very -- 836 -- EUR 835 million, and this is very significant improvement against last year. It's on an outturn basis, on a simple comparison, EUR 45 million. But if we take into account the different ForEx environment as we have had last year and this year and the negative impact, that different ForEx environment had on our transaction and translation ForEx impact, the basic difference, the basic improvement gets to EUR 111 million.

And this is on a quarter where we have been basically having to live with some significant challenges. As we have been explaining, on one side, Easter holidays, has been falling in different way this year '18 and last year. And this has, of course, created some differences in margin generation and profit generation for some of our companies, especially companies as Vueling or Aer Lingus or Iberia, with a significant seasonal impact on their pattern, on their production pattern.

Also, as you know, it's fuel price. Fuel price has been increasing very substantially. We have a high level of hedges. We are around 75% of our consumption for the year already hedged. But of course, it we move from $500 per ton, that was the level of last year, to $700 -- above $700 this year. That makes a significant challenge.

The other one has to do with ATC disruption, basically related to strikes, and very specifically European French strikes, which have been affecting very particularly Vueling, especially Vueling and its operations. And we have been making a deep dive in the impact, the direct impact on their cost base and we'll be reaching a figure of around EUR 20 million, which is very substantial. And basically, as you will see afterwards, explain most of the weaker performance of Vueling through Q2 2018.

So when we get to how we've been producing these operating profit level and figures, it's through a growth in terms of ASKs of 5.8%, which has been provoking demand improvement on our planes, on our flights of 7.6%. This means we have increased our seat factors all over our network. So this means that basically, we are facing demand on our main strategic markets, which is growing ahead of our capacity. And that's a very positive and important signal for us and for the way we are growing.

Because at the same time, at the same time, we are improving passenger unit revenue by 2.3%, which is, I would say, a very substantial improvement. Taking into account again, this quarter 2 has been suffering because of different Easter Holiday calendar. So very happy with this 2.3% improvement. I'm also happy because what we are seeing in terms of signs on our booking profile for Q3 especially is basically showing a very type of aligned improvement into the next future.

Worth to say our nonpassenger revenues have also been growing. Our revenues have been growing significantly above the ASK growth figure. So our total revenue has been improving by 2.7%. This, as I will explain, has also has an impact on how we calculate our cost, our nonfuel cost especially. Because part of this additional revenue growth is not related to our ASKs, it's not related to our flight operations, and it brings costs on a cost model which are not related to ASK. It is having to do basically to do with Iberia third-party MRO business, or British Airways Holidays, or Avios or others. So that's something that we'll try to explain how it's been impacting for us in the quarter.

On the cost side, basically, we are showing minus 2% on nonfuel unit cost performance against last year. Of course, it has to do with our underlying performance, but also through the positive comparison against the disruption, the blackout, that British Airways was going through in June last year. So a significant amount of cost reduction has to do with this fact, this one-off fact, that affected our figures negatively. And we were very clear, it was EUR 65 million last year Q2.

But this year, we have also this, I would say, non-transport costs growing, and our own disruption costs having to do with the ATC strikes. So if we reach for a cleaner underlying figure of improvement in terms of nonfuel cost, which we will be reaching a figure that surpasses clearly the 1%, maybe in the range of 1.5%, which is very well aligned with our medium- and long-term target in controlling our nonfuel cost base.

So finally, fuel cost. Fuel costs have been dragging our results and our margins in this quarter 2, and they represent an increase in constant currency and unit terms of 15%, as you will see later on.

As a whole, we explain here how the bridge of operating profit is flowing from the figures last year into the figures this year. So if we take the adjusted of the IFRS 15 figure, which was EUR 790 million, and we include the negative impact of ForEx this quarter, which is EUR 66 million, we'd get the regular rebase for the results this year.

And of that type of regular base comparator, we've been generating margins and profits through growth, EUR 46 million. And very substantially, through the management of our passenger and nonpassenger unit revenues, EUR 120 million, EUR 50 million, so very substantial improvement on our unit revenue base and on other revenue sources of business.

And then it's the fuel cost, which has impacted negatively on a constant currency unit terms base by EUR 186 million. If you compare passenger revenues, nonpassenger revenues and fuel costs, you can acknowledge how we've been offsetting, we've been transferring, we have been basically mitigating the significant impact on the cost fuel prices through improvement on the revenue side. And the proportion is very high. It's very high especially for a quarter that has not been benefiting from Easter holidays.

Finally, again, a very important and positive role being done by the management in managing nonfuel cost, which has created an improvement in terms of EUR 85 million. But that it's basically affecting positively, as you will see afterwards, all of our cost lines. So it's affecting positively not only labor costs, but also supplier cost and ownership.

And this helped -- it shows our capacity development to Q2 and our revenue development, unit revenue development at the same time. So relevant to comment basically North America, and North America with a very significant capacity increase, 10% up against the last year across the board. So half of this 10% is attributable to British Airways growth, the rest is basically the rest of our company, so Aer Lingus, Iberia and LEVEL. Also half of this increased capacity has been dedicated to new routes, the other half has been basically increased frequencies in routes that we already operate.

So taking into account this significant growth, we value positively, very positively, just a small reduction in unit revenue. Because if we take into account the proportion of total revenues that we've been able to grow on this quarter, it's around 10%, which is a very important figure. And it reflects, I would say, very similar revenue projections that we have been seeing in our competitors, especially in the U.S. side and probably better than our European peers.

After commenting North America where we still see, I would say, positive trends coming through Q3, and they are very much related to premium traffics which are holding very strongly, we should be commenting Europe. Europe has been also a high-growth region, 5.1% in terms of ASKs, but unit revenues have been very strong. Capacity demand equation in intra-European traffic is still a very strong one, and it has enabled us to increase unit revenue by quasi 3%.

Domestic is also positive. I guess the negative figures that we are showing is slightly negative has to do basically with stage length. As stage length happening in the Iberia network and in the Vueling network and having to do with the increase in the Peninsula to island traffic, which, as you can imagine, has double stage length are the intra-peninsula traffic. So this minor reduction in unit revenues with this domestic improvement of 8.3% means that we have been improving margins on that segment of our network, the same as Europe and North America.

We see also continued strength on our Latin American and Caribbean markets. And that despite having to go through difficulties in countries as Argentina or Brazil. As experienced, even in Argentina and Brazil have been holding steadily. And unit revenues, as you see, have been improving very significantly, with growth levels which are in excess of 6%. So Latin America is an area of our network which is still performing very strongly. And what we are seeing into the remainder of the year is showing still that trend.

AMESA is also improving. Basically, we have been reshuffling our operations there and getting to a better mix in terms of unit revenues. Asia Pacific maybe is the slightly weaker side of our network. And it's a varied performance. I guess the negatives are mostly concentrated in Hong Kong, where a lot of, I would say, capacity has been deployed specifically by Cathay Pacific.

So jumping into the costs side. Fuel, as you see in constant currency terms, has been increasing by 15%. And the rest of our nonfuel cost lines have been reducing their unit cost basis, in some cases on a very substantial way. So you see employee unit costs for the group being reduced by 3.7%, and that's a combination of improvements coming from the pension fund agreements with British Airways and their Athens project.

Also the result of Plan de Futuro II, Iberia rolling into a full year of type of progress. But it's also the case of Aer Lingus where they have been growing very significantly with a very type of small or nil growth in terms of number of employees. So the employee improvements in unit cost that we are showing there are totally structural and have to do with measures and plans that we have been implementing in a very efficient way. Supplier unit cost has also -- have also been improving by 1.5% in this case. And it's also, across the board, has to do quite significantly with maintenance cost.

Also, ownership costs are showing significant improvement because in this specific case, you need to remember that we are producing significant improvement in terms of our fleet and a renewal of our short- and long-haul fleets in British Airways, Iberia and Vueling. So renewing the fleet with new-generation aircraft and keeping ownership costs, unit costs on the negative is, again, a significant achievement.

So as a whole, that 15% fuel cost, combined with all these negatives, are showing a total CASK increase of less than 1.9%. This is basically the way or one of the significant ways that we're using to offset the cost, the market price increases in the fuel price.

This is a typical chart that we are showing every quarter, trying to show you our sensitivity and our best estimate for the remainder of the year. We are using, in this occasion, reference for dollars per ton of kerosene of $700, and dollar-euro rate of $1.17. This has been very volatile, so that is sensitivity that will be affecting these figures through the next quarters.

We are getting to a total fuel bill for the year, which is EUR 5.3 billion. It's lower than what we showed in the last quarter. It's lower both because of rounding. So it's not EUR 100 million lower, that is a rounding the impact that is affecting the final figure. But there's also impact having to do with a slight capacity decrease that we are forecasting for the remainder of the year and also variance having to do with efficiency.

We've been, in the last quarter especially, penalized in terms of efficiency because of the disruptions. You can imagine, especially in the short-haul fleet, disruption has been provoking a lack of optimization on our routes, on our approximation to the airport. We feel that for the remainder of the year, we are going to be able to improve our efficiency ratio, not only because disruption probably is going to be fading down, but also because we are going to have full impact of the new generation fleets becoming operational, which are 787, 350 and 320neos.

And this is the chart showing ROIC, ROIC performance. So at the group level, ROIC performance for the last 4 quarters has been improving, has been reaching 16.2%. Our operating margin trend, again, for the first -- for the last 4 weeks has been improving by 0.2 percentage points, and it's reaching 14.7%. So high figures not only for us but also in reference to most of our peers.

By companies, Aer Lingus is still showing an exceptional performance. ROIC for that 4 quarters have been reaching 27.8%, nominal margin for last quarters, 17.6%. Operating margin trend against last year, 2% points up. Very, very strong performance. The same as British Airways. British Airways reaching operating margin of 15.8% in the second quarter, and in terms of trend for the margin, again 1.6 points up. ROIC, 17%. So very strong, very efficient figures from a point of view of our use of capital.

We've seen small deteriorations for Vueling. They basically have to do with the struggles with their operational challenges with ATC strikes and all this stuff. And we are seeing a small type of negative difference for Iberia, and this one has very much to do with the new generational aircraft coming into the quarter at the late stage. So we have them in the denominator as use of capital. We don't have them operating, in the numerator. So that's creating a temporary reduction in the case of Iberia. We guess that for Vueling, it's also going to be temporary reduction.

So if we follow by companies, again, their performance for the last six months. This is half of the year results. Again, we need to give a little bit of special attention to Aer Lingus' performance, with operating results jumping from last year's -- doubling last year's figures, and operating margin figure reaching 11.5%, so 5.2 percentage points against last year, which is a very high figure. So showing a very efficient cost performance.

We are sorry, there were some manual mistakes on the percentages for the RASK, CASK and the CASK ex-fuel. The figures -- the negative figures that you have in the chart in the screen this time are the correct ones. And they show what should be expected. So very high growth. For RASK is slightly negative on ASK increase of 9%, so this shows the strength of the underlying market that Aer Lingus is basically working. And then CASK associated with this level of high growth coming down by 6.3% or 7.6% in the case of ex fuel.

Strong performance again in sterling for British Airways. The operating result jumping GBP 137 million in terms of operating profit millions. Operating margin, 1.7% up. And good figures both in terms of RASK, 2.6% up; and also CASK ex fuel, employee cost per ASK minus 2.8%. So a very strong quality good performance.

Iberia, again, improving the operating result, mentioning again the difficulty because of Easter Holiday calendar, growing by 5 point -- 4.7%. In terms of demand, RPK is 7.8%, so very important impact to the improvement. RASK reduction because of the growth, but basically also because of the sector length increase, so 2.1% is basically having to do with the 3.4% RASK reduction. But again, you see that CASK there falling by 4% and the CASK ex fuel falling quasi 5%. So very strong figures again. And employee cost, same.

Vueling is basically reducing operating results, having to do very with this repeatedly mentioned disruptions. If we take into account that their -- just their cost, that we'll -- someday we are able to identify directly with disruption, abnormal disruption account for EUR 20 million. So the cleaner comparable with last year would become clearly positive. But in terms of RASK, they have been able to improve quasi 1% up. Their cost figures are basically damaged because of this disruption.

So below the line what has happened, we have an improvement in terms of net finance income and expense. We have a more precise one that we have isolated having to do with pension accounting and how the closing of NAPS for accrual will have a recurrent improvement, a recurrent positive impact on our, I would say, financial cost-related spend, which have become positive in this occasion.

So profit before tax has been jumping from EUR 835 million to EUR 1,035 million. Tax rate has been kept as the 19%, 20-ish rate, which is the one that we want to keep and that we are keeping consistently. So profit after tax has been improving from EUR 669 million to EUR 835 million. And on a fully diluted EPS comparison, we've been growing from EUR 0.30 to EUR 0.39, so close to 30% growth in terms of the earnings per share is a very substantial improvement.

And the rate at the end of the figure will be basically coming down because H2 is not sustaining this 30% -- increases in EPS. But we -- what we can say is that we are very comfortable in being able to keep the guidance that we did at the Capital Markets Day, in terms of the medium-term improvements of EPS we said at that point in time was going to be above 12%+.

So in terms of balance sheet, again improvement, again getting stronger. Adjusted net debt, as a summary, in relation to EBITDAR has been improving from 1.5 to last year to 1.2 this year. On balance sheet debt, we have to call it now cash, it's EUR 714 million positive with a growth -- a moderate growth in terms of our cash and interest-bearing deposits positions, and the reduction in balance sheet gross debt. So it shows that we are keeping, maintaining a very strong financial position. And we are comfortable to be able to assume future decisions both in terms of investments and also in terms of shareholder return.

So having said that, I come back to Willie.

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

Thank you, Enrique. So we continue to grow in a manner that is accretive to the business. You can see that we tapered our growth for the year, now we're reporting an expected growth of 6.5%. That's down from the 6.8% that we set at the end of the first quarter.

I should say by the way that, that 6.8% did not include the plan for the NSO. If I do like-for-like, it's actually 6.2%. If I strip out the capacity that we're adding in Vienna, that's 6.2%.

So this is as we said we would do, as we go through the year looking for opportunities on a tactical basis to eliminate some of the growth that will help to improve the underlying financial performance.

All of the airlines have brought down their annual growth, with the exception of BA, and that's principally around the now expected utilization on the 787s, which is now better than we had originally thought given the progress that Rolls Royce have made on the engine issue. So now looking at 6.5% against the previous reported 6.8% for the year.

Pleased that we are reiterating our guidance, at current fuel prices and exchange rates, we expect our operating profit to show an increase year-on-year. And just to be clear, that's against the reported operating profit of EUR 3,015 million last year, not the restated profit under IFRS 15. So showing an improvement against the reported EUR 3,015 million operating profit last year. And both passenger unit revenue and nonfuel unit costs are expected to improve at constant currency.

So we're very clear in terms of the approach the company is adopting towards our shareholders. We will reinvest in the business through accretive, organic growth and we have a commitment to a sustainable dividend. And surplus cash, if we're not using for inorganic opportunities, will be returned to shareholders. On that issue, I should say that there's nothing new to report in relation to Norwegian from what I've said at previous announcement.

And just to reaffirm that we're about halfway through, just halfway through the current year share buyback with EUR 256 million of the EUR 500 million as of 1st of August of this year.

So we continue to make good progress on our nonfuel unit costs. We're on track to achieve our stated target of 1% reduction in nonfuel unit cost per annum. As we said, it's not going to be 1% every year, but we're making good progress. And there is more to come. And we have a plan that gives us confidence that we can deliver on that at British Airways, more to do on Plan4, in Iberia the Plan de Futuro Part II. Vueling NEXT, and the Aer Lingus continuing very effective value model, which is proving to be an excellent investment on the part of IAG. And all of that then, combined with the expansion in LEVEL.

The LEVEL performance is very encouraging. Still early days. We've been operating out of Barcelona for a year now. The sold seat factor out of Barcelona is in the order of 97%, 98% for June and July. So we will be showing you some stats specifically for LEVEL as we get through the next few months, which clearly is distorted by the launch of LEVEL out of Paris on the 2nd of July and the launch of LEVEL out of Vienna on the 17th of July.

You can see the network that's proposed initially for the 4 aircraft at Vienna, 14 destinations around Europe. And these principally are destinations where we already have a strong presence through the group and a strong presence in particular in Spain through LEVEL.

Out of Paris, we're currently flying to Montreal and Guadeloupe, we'll add Martinique and New York later on in the year. We've switched to Boston from Barcelona instead of San Juan, and that's proven to be very effective. So we're pleased with the performance of LEVEL, and we're very pleased with the launch of LEVEL out of Vienna.

On Heathrow, as you know, the national policy statement received overwhelming support in Parliament. I think the majority in favor was stronger than I had expected and, indeed, I think stronger than the government had expected. So the next stage of this is the second stage consultation by Heathrow, so that they can then develop their development consent order, which will be submitted in winter of 2019 based on current plans.

It's well known and expected that there will be challenges to the national policy statement, and already, a number of parties have come out and said that they will be looking for judicial review. So the timing of this is likely to be impacted by these various challenges and reviews. But if you assume that everything works to the Heathrow plan, you would see development consent order be granted at some stage in 2021, and then construction starting shortly after that. But they have said that there might be some pre-work done before the DCO is received if that is the case.

We still believe that, if this goes ahead, the expected operational runway will not be until 2026, 2027. And our position remains very clear. We support the expansion of Heathrow, but it's not at any cost. It has to be done in a cost-effective manner, and it has to be done without increasing passenger charges. And we will continue to lobby very hard in relation to that. And I'm pleased that the government has responded and acknowledged the need for that to happen.

So we remain cautious about this in relation to Heathrow's plans because, quite honestly, we don't believe Heathrow as it's currently managed can deliver a program in a cost-effective manner. But we will keep the pressure on to ensure that if this does get to go ahead, it's done in a way that won't involve an increase in charges at Heathrow.

We've talked a lot about air traffic control and specifically identified the operational challenges that Vueling has faced because of strikes in Marseilles. As you may remember, I showed a chart which clearly identified the extensive airspace controlled by Marseilles. Those strikes haven't continued in July. However, you'll see from this, this is a report from Eurocontrol there's a lot of very interesting information on the Europecontrol website if you're interested in following up on this. But despite the fact that strikes are finished, you can see July was even worse still. And these are record delays. So what you see here is a chart of the minutes, total minutes of delays where they take the total minutes that air traffic control delayed flights over the month and they define that by delays in the airports through air traffic control, but the darker color there is the en-route and that's the one that's specifically of concern to us. And just to give you some figures for the year-to-date because I think they do demonstrate just how challenging the environment is. To the end of July, there were 6.3 million flights operated through the Eurocontrol airspace. That's an increase of 3.5% over 2017. There was a total of 11.9 million minutes en-route delays, so that's a 126% increase on 2017. 2017, for the full year, was 9.3 million, so we're already at 11.9 for the seven months against 9.3 million for the full year. And 54% of that was a direct result of air traffic control capacity and staffing. 18% was as a result of an industrial action. So in total, the vast majority of these delays are being encountered because of inefficiency within the ATC system in Europe. So it can be resolved, but it requires air traffic control providers to address their staffing issues. And this is of particular relevance in Karlsruhe in Germany where actually, traffic through their airspace has declined this year. And that's principally because they didn't believe, strangely enough, that traffic would grow. And rather than increasing their capacity and staffing, they reduced them. So for some reason they thought that Europe was not going to see an increase in traffic, which we have seen.

So these issues can be resolved, but it requires ATC units to reflect the growth in the industry but also to improve their efficiency. And we will continue with our competitors through Airlines for Europe to push governments to address this issue. But I expect it to be a feature of our business this year and potentially next year.

So there you have it. I think a good set of results. We're certainly pleased. Good performance in the first half, challenged by the fuel price, but we've been able to offset that to some degree through improvement in our controllable costs. We've seen a constant currency improvement in unit revenue and constant currency improvement in our unit cost. We've continued to invest in the brands to the benefit of our business and our customers and the future. And as I said, that's a very clear feature of the business. Our cost performance will continue to improve. We remain optimistic about the second half of this year. There's further upside in relation to a number of the airlines, and we will continue to reward our shareholders for their commitment to us as we continue to generate good levels of cash and distribute that cash to our shareholders. So very confident about the performance for the rest of this year and remaining confident for -- so look forward to 2019 based on the early planning that we're doing, but we'll clearly talk more about that as we go through the year and our Capital Markets Day in November of this year.

So I think at that point, I'm going to hand over to Andrew, and he will direct the questions to us.

Andrew Light - *International Consolidated Airlines Group, S.A. - Head of Investor Relations*

Thanks very much, Willie, Enrique. We are now ready for questions. We have the Chief Executives of all the operating companies on the front row, so ask whatever question you'd like. We're not using the mics in the back of each seat. We've got -- David and I have the mic each, so fire away.

QUESTIONS AND ANSWERS

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. Three, if I may. Can you give sort of an update on how cargo is performing and also MRO? I know you were doing quite a big study on MROs since Capital Markets Day. Secondly, obviously, good load factors. I just wanted to get your views and if you think that's sustainable? And is the goal still kind of revenue maximization? And then just lastly, on LEVEL. I mean, do you think now we'll start to see it as a separate reporting unit?

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

Okay. Lynne is here, so Lynne do you want to comment on cargo?

Lynne Embleton - *IAG Cargo - CEO*

Okay, so despite fidget spinners this year, we've actually had a great first half. At constant currency, the revenues are up just short of 10% And within that, we're particularly pleased about our premium products, been going really going well so far. So it's been a good year, the market is slowing slightly from the double-digit type growth that the market was seeing. But so far it's still positive that we're going to have decent 2018.

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

On the MRO, we're making good progress. So what we're doing at the moment is driving efficiency within the MRO units that we directly control, and that's principally in Iberia where they provide services to third parties as well as their own services and maximizing the efficient use of our own facilities before looking at third party suppliers. So we're doing both, we're putting work in-house where it makes sense, and Iberia has certainly demonstrated that it does make sense that they can compete on the market's price basis with our competitors globally. Their engine shop is continuing to perform very well. And where that is the case where we have efficient internal facilities, we will invest and utilize those facilities to the maximum. And then where we don't have sufficient capacity, we are going to third-party suppliers. And we've run competitive tenders against a number of key suppliers to ensure that we get market prices for all of our airlines. And that helps us to benchmark the internal performance. So we're very clear that our maintenance costs are in line with best practice in the industry. There is more improvement to come through increasing efficiency internally within British Airways where we do a lot of the heavy maintenance, airframe maintenance in our own facilities at Cardiff and Glasgow. And we're continuing to look at opportunities to improve that. So I'm pleased with the progress we're making. There is more to come, but it's working well so far. And on load factors, yes, we believe it is sustainable. I think it's one of the values of having Aer Lingus in the group and better understanding their value model that they've demonstrated to be very effective. So the load factor improvement is in all of the airlines. But what it is we're looking at, because we think we undersell our performance to some degree, because when you look at the low-cost airlines like Ryanair and easyJet, they report their sold load factor, not their occupied, which is what we generally do. And as you know, if you have a non-refundable fare, you can question whether that seat should be counted as being flown in or not. So they count the seat as being occupied and we traditionally don't. So we're looking at how we report that so that you get a better like-for-like comparison and it enables you to better understand our performance. And in relation to LEVEL, yes, in due course it will. There's still a lot of noise in the base, so from a traffic stats point of view and a launching out of Vienna on the 17th of July midway through the launching in Paris on the 2nd of July with some operation. Look, as we go through that, we'll clean it up and we'll start to give you more information that's specific to LEVEL. But at the moment, you can see traffic stats are embedded in -- in the case of LEVEL, Spain is embedded in the Iberia figures, but we'll give you more visibility on that as we go through the year. We're very pleased with the performance. And I think that's -- if you look at Barcelona with one year of operations, it gives an indication of where we see LEVEL going and that's very encouraging. I think our reported seat factors in June and July in Barcelona were 94% or 95%, and sold seat factor was 97%, 98%.

Daniel Röska - *Bernstein - Analyst*

Daniel Röska from Bernstein. First question, maybe on the demand environment. I know you said demand on the main strategic markets remains strong. And if you look at the European GDP, 2%, 2.2% somewhere around there, so the kind of uplift on GDP you can see seems quite high. Do you expect that to continue kind of into next year and why? So what are the key drivers that will help us see a high GDP multiple of your demand? Second question, I'll stay on LEVEL, LEVEL and Vueling. It seems as though LEVEL is solidifying itself is as another airline that will reported in due time. I think there was a question once whether LEVEL would move into Vueling, or whether it was a combination, so how do you think about the split between the 2? Is that kind of a geographic split with LEVEL more being around Central Europe and Vueling (inaudible)? Any light on that will be appreciated. And lastly, I'll pick up Norwegian and just ask you how long you'll hold on to the shares and if you think that's a long term investment?

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

We do believe demand will remain strong. Certainly, it's -- we're at the early stages of looking at our business plan through to 2023, and specifically looking at forecast GDP for 2019, 2020, and making a judgment ourselves in relation to what the various economists say in relation to that. But underlying, we see good demand in all of the markets. I think that's been a feature of this year, and we believe it will continue to be the case in 2019. So we'll talk a lot more about that obviously in November. But based on our early assessment, we gave a short presentation to our board yesterday just to reaffirm that, when we looked at early capacity plans for 2019 based on where we see economic growth in 2019. So -- but that's something that we remain comfortable with. On LEVEL, you actually put it very well. We think both LEVEL and Vueling brands can operate efficiently in the market. The Vueling brand is particularly strong in Spain and in Italy where you would expect them to be strong. The brand recognition is very strong there. I think some markets continue to struggle with the name. We did a number of interviews on radio and TV and press this morning. They all talk about Aer Lingus, British Airways and Iberia, and they're afraid to mention Vueling. So I think, yes, --yes again the other one, LEVEL we clearly want to use any avenue available to us to raise awareness of the brand for long-haul benefit. So this is again an effective way of promoting the brand without spending a lot of money and launching it in Vienna in the way we did. It's a huge publicity in that market. We see that's a market. And that's not just Vienna, it's Germany, Switzerland, Czech Republic. We had, I think, 8 TV stations turn up to interview me on the day of the launch in Vienna. So it is all about effective development of the brand and brand awareness. And on Norwegian, we will not be a long-term shareholder in Norwegian unless we acquire the business. So we're very clear on that. The small stake that we took was with the view to, as I said previously, initiating a discussion with Norwegian. We haven't had any discussions with them since April, I think it was, was the last contact that I've had with them. So I've nothing to add to what I've said. But if we decide that we're not going to proceed, we're not going to hold onto the shares, and we're very clear about that. But obviously, if there's something to say, we'll say it and I have nothing to say at the moment.

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

James Hollins, Exane BNP. Three, please. Enrique, you seem to guide to Q3 unit revenues similar to Q2. I was wondering if you could just confirm if that's the case and whether maybe you could beat the 2.3% you saw in Q2 based on a, I think you said, a strong booking outlook? Secondly, maybe you could quantify the premium versus non-premium RASK in Q2. Again, I think you cited strong booking trends in premium, but maybe some more detail on that. And then thirdly, your guidance outlook, obviously it's been retained, I was wondering without -- and obviously, you flagged ATC being a massive problem in July as well. I'm wondering if you we sort of stripped out the ATC strikes, maybe that guidance could have been slightly better. And notwithstanding that, do you think you'll be well ahead of the 12% earnings -- annual earnings increase that you've look for long-term?

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

I'm afraid we're not going to be quantifying at this stage about our figures Q3 or for the remainder of the year. That's not how we transmit our messages. But I think we should reinforce the basic trend that I was signaling. So what we see around Q3, and it's quite a bit at this moment in time, is encouraging. It's encouraging on the revenue side. Also, it's encouraging in the cost side. Fuel is going to be creeping up as we progress into the year because of the hedges being unwinded. So the challenge is going to become slightly greater through Q3 and Q4. But we're still confident in being able to beat the former year's figures operating profits on the 2 quarters even after restatement. So that shows a little bit of the type of trending that we can share with you today. In terms of premium versus nonpremium, again, we don't quantify the differences. But again, what we can say is we've been seeing through Q2 and early Q3, which is for July is a very premium (inaudible) month. So it's true we are seeing a very strong premium for long haul, especially North Atlantic; but also short haul, which is a surprise because premium short haul has been a segment of a business that we weren't so confident about only 2 or 3 years ago. So that is a little bit of a comeback there. So that's encouraging. That's part of the 2.3 improvement in unit revenues that we have seen in the second quarter. And finally, guidance in respect of ATC. Of course, ATC unknown is something that refrains that, so being more precise, in terms of our full year guidance. It's true, but we need to keep that type of cautiousness because we don't know what's going to be happening after we come back from the holiday in August. We don't know. So we prefer to retain a little bit of cautiousness. And it's true, if we had full certainty on that one, probably -- and by the month of October we will have it, then we could be more concrete in terms of our improvement projections both in terms of operating profit and earnings per share.

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

We're certainly very comfortable with consensus where it is at the moment. But we do anticipate air traffic control will be a feature as I said of the business, and it will take a bit of time to address that. But it can be addressed. So I don't see it as being structural, I see it as being a temporary impediment to the operations, which will certainly challenge us in this year and probably challenge next year. But with the right attitude and approach, air traffic control providers should be able to address this for 2020, possibly 2019, but I think more realistically it will be 2020.

Rishika Dipak Savjani - *Barclays Bank PLC, Research Division - Assistant VP*

It's Rishika Savjani from Barclays. Three for me also, and the first on transatlantic capacity growth. I look at your overall group, clearly, Q3 and Q4 are stepping up in terms of the rate of capacity growth. Therefore, is 10% the right number for the second half on the transatlantic? Or will it be higher than that? And what will be the mix between the new routes and existing routes? The second question I wanted to ask was just develop a bit more on LEVEL and your Austria operation, Vienna operations. Can you explain why you decided to brand those as LEVEL and why you've not kept LEVEL as a long haul only brand? And then the third question, the buyback. And if I look at what you've done already in the first quarter, sorry in the second quarter, you've done half of the buybacks, the EUR 500 million. And if you keep at this pace you'll be by -- when you report your Q3 results. Is there any upside on the buyback, please?

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

Okay, on transatlantic, we're not planning any additional new routes for the rest of this year, I certainly I think that's -- we may add some capacity to some of the existing routes that we've launched but there're no new routes that are planned for the rest of this year, with the exception of LEVEL Paris, which we've announced, which we'll do Newark starting in mid-September. So the capacity is likely to be similar, but it'll be -- these routes are still new as we go through the rest of the year because most of them were started at the beginning of the summer, so we don't have the third quarter comparison or a fourth quarter comparison. On LEVEL, yes, we did debate whether LEVEL should be only long haul. And in fact, we concluded some time ago that we would use the LEVEL brand for both long and short haul, we just used it a little bit sooner than we thought. And as you said, it's opportunistic. We felt that it gave us the opportunity to raise awareness in the European markets, particularly the -- what we call the DAC region, of LEVEL, given that that's an area that -- a market that we are looking at for LEVEL long-haul growth. So it just makes that market more aware of the brand. And clearly, one of the opportunities we have is to provide feed from the short haul network into the long haul. Now we can do that from other parts of the group as well. But there's nothing to read into that other than it's a pure opportunistic move by us. And on the buyback -- well the buyback is in the hands of...

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

Yes, well, buyback, nothing new. And also, we've been progressing. A lot on execution. And we'll have -- we have an arms-length project, sorry, model (inaudible). But we really don't interfere in their day-to-day decisions, when and how much we buy, and how we spread. So we could -- what we're expecting is a gradual execution for the remainder of the program from now through the year end.

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

But given what I said earlier, the board is very clear that if we're not investing the surplus cash that we have in inorganic opportunities well then, the board was clear that that cash, that should be redistributed to shareholders. And we've always said it's just a question of the form with which that will take. But now is not the time to talk about that, the board reaffirmed that that's the position. But we've not debated anything and that's a debate that the board will have probably at the third quarter chairman I think we would do it?

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

Neil Glynn from Credit Suisse. If I could ask 3 also, please. The first one, just more looking for a bit more color on the transatlantic underlying performance. I drilled down into British Airways, obviously the heartbeat of your transatlantic business. That route was up 2.6%. I guess given the APAC weakness, is it fair to think that the transatlantic performance for BA was better than the BA average? Second question, you introduced basic economy I think in April on the select routes. The new distribution model has been live for nearly 3 quarters. Are those initiatives bearing fruit? Are they actually helping revenue now? Or is that still very much a work in progress? And the third question, maybe a little technical. But if I look at the cash flow statements, the payables and deferred revenue line, the inflow there was actually lower year-on-year. Does that mean anything in terms of how one should think about the third quarter? Or are there multiple things going on there beyond forward-bookings?

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

On the transatlantic, you're right to say the transatlantic was -- for British Airways was better. Performance for BA -- and don't forget, BA had to move a few new routes as well. Fair to say Alex, Nashville was much stronger than we had expected they were going to be. If you want to comment to that.

Alejandro Cruz de Llano - *British Airways Plc (UK) - Chairman and CEO*

Precisely that. For a brand new route, perhaps because of the strength of the U.S. market this year, the start-up of Nashville as a brand new route was really unexpected. I don't know if you want me to comment on NDC and the basic fares. NDC itself hasn't been driving unit revenues. It's given us a very good insight into how to diversify our distribution capability. That will ultimately lead towards higher unit revenues. But the basic fare introduction has been quite interesting, particularly in the selected routes in the U.S. That allows us to not just compete better, but also to provide options of trade-up, which -- were there before, but they've become even more obvious. But that actually pushed as well the revenue environment, so it's been quite useful.

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

Stephen, would you like to comment on that issue as well?

Stephen Kavanagh - *International Consolidated Airlines Group, S.A. - CEO of Aer Lingus*

Yes. We introduced the saver fare back in the third quarter of last year. It's allowed us a price point in the market that essentially we took EUR 50 off our lead prices across the Atlantic and gave our guests the opportunity to buy up. I'm happy to report that, for us, it's been revenue-neutral because the guests have bought up. And so it's allowed us to drive load, drive relevance in the marketplace. And for us, the distribution model we still are focused on an 85% direct ambition. We see a direct relationship having positive impact on unit cost, but also given us the ability to retail and up-sell. So we see -- we have seen a lot of opportunity from our saver fare. We're at approximately 15%. It been accretive to load. It's essentially allowed us to do be more competitive, particularly in the price-sensitive Irish marketplace. And pleased to report that we've been managed even with a lead fare reduction to keep revenue -- unit revenue-neutral with that rollout.

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

Yes. I guess working capital variance that you have maybe identified have basic algorithms behind, which is about the closing cash element of the agreement with the pension fund trustees so it was EUR 180 million. That was paid just at the beginning of the month of April to satisfy and include the employees in the new agreement. So that's a cash-out that didn't happen last year. But there is probably a little bit of noise around unflown tickets always, and that has to do with -- the trend is later and later bookings every time. So the amount that you hold there at each closing (inaudible) and probably also a little bit about selling, but nothing changing any trend.

Alex Paterson - *Investec Bank plc, Research Division - Analyst*

It's Alex Paterson from Investec. Three questions, please. Firstly, could you just say what your exposure to the Argentinian peso is and whether you're able to hedge that? Secondly, just on Heathrow. Apologies, Willie, I can't remember how you put it, but I think it was along the lines of that you're not confident that that model allows for sort of efficient delivery. What kind of changes would you like to see to give you protection on that? And what -- if that doesn't happen, what would you do? And then thirdly, perhaps unkindly, I think if I've got the maths right, your profit would be flat ex the change in disruption charges in the second quarter. Is that what we should look for in the second half?

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

Just -- I'll take the last one. If we just showed you the Vueling -- we didn't show you the group impact of that disruption charge in the quarter. We highlighted that Vueling was specifically hit. All of the airlines had a disruption charge. And it's not identifying all of the disruption. So -- we had currency as well in the quarter. So I think the underlying -- if we strip out everything, the underlying performance in the quarter was still positive. On the Argentinian peso, Luis can comment on this. We saw that devaluation of the peso. We haven't seen...

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

(inaudible)

Luis Gallego - *International Consolidated Airlines Group, S.A. - Chairman and CEO of Iberia*

Yes. In the case of Argentina, what we have seen is that we had a downturn, but after a period of time the market recover and now for example LEVEL is working very well. And in the case of Iberia, even we are adding capacity there. So we don't see now any problem there.

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

It's had a very short-term blip with the devaluation but it hasn't had any structural impact on the performance.

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

The economic impact, clearly below materially. So the flow of our repatriation of funds has been basically been kept maintained.

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

And on Heathrow, what I've said is I don't believe that the management team at Heathrow can operate in an environment where they've got control of cost because they've never had to control cost. What they control is how much money they spend, which is as much as possible. They're not going to be able to do that with the development of the third runway. So I think my view is very clear. I wouldn't normally comment on management of another organization other than given that this is so important to us. I've made my views very clear to the Chairman of Heathrow that I don't believe the management team there has it in their DNA to be able to control cost. As I said to him, if they were buying aircraft, they'd be paying the list price for aircrafts. We would never do that. But it's because they've been incentivized to do that. And we know that from things that they buy at the prices they pay from them compared to what we would pay for the same. So it requires a complete change in attitude in Heathrow, and they're not going to get that unless a change the people. And I have not seen any evidence of a change in attitudes. And if we don't see that change in attitude, we will continue to call it out, and we will -- and I think this is where we have been effective. With the government we've made it clear that you can't trust Heathrow. That's our strong belief, and therefore, you have to put a structure in place that can control Heathrow, and that means strengthening the economic regulation, strengthening the tools available to the CAA and making it clear the responsibilities that they have in relation to ensuring that costs don't increase at Heathrow. We have been very pleased with the statements being made by government and the statements that have been made by the CAA. And we will continue to hold them -- we put them under the spotlight and we'll identify anything that we believe is inefficient, and I suspect you're going to hear us talking a lot about that, but I think what's good here is that everybody at an industry level, wants to see Heathrow expand. It's very clear that they only want that if it's going to be done in a cost-effective manner.

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

Damian Brewer, RBC. Just one question. (inaudible) so clearly with a slight shift in mix to leisure price-sensitive parts of the market. But you already talked about is you think of your next plan in terms of the long term, given what you done in H1, are you thinking of changing the shift in the business again to more of the price-centric parts of the market given what H1 delivered?

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

I don't think we're changing. It's a good question, but I don't think we're changing. I think what we're doing is exploiting the opportunities that we have. And clearly, with Aer Lingus as part of the group now, it's very different. Their model is different to the traditional model. It's been very, very effective, and you can see that in the financial performance. But you can also see it in the growth of their network. They're now operating 17 transatlantic aircraft, 13 A330s and 4 757s. They're flying to 13 different destinations in North America. So we always believed that there was a market opportunity there, but I think credit to the team there that demonstrated that it's even better than we thought. So I think we'd be incredibly foolish not to exploit that. It doesn't change the central gravity or the focus that the other airlines we'll have. British Airways is very clear that it will invest in product, particularly in the premium cabins. And you're going to see a lot of that in the coming years. This isn't a short-term investment. This is a medium-term plan that will see BA invest significantly, particularly in the business class -- product in the long haul with the new seat that you see when we take delivery of 350-1000 next year, and Iberia doing the same. So yes, I think there's a big market out there. We're competing effectively in most segments and we think they're, particularly in the long haul low-cost, there's a profitable segment that's underserved and not fully exploited yet that we intend to be a significant player and -- the difference between our attitude and approach to that is we believe we can do that profitably and generate the returns that we've set for all of the airlines. And this is the beauty of IAG. This is why we think we're unique. We can exploit all of those opportunities in all segments of the market using different brands, being effective and being focused with each of the operating airlines, doing what's right for their segment and their customer base and having different customer propositions where that makes sense, but working together to learn from one another and working together to make sure that we're getting the maximum benefit through the scale of the operation. And I really do believe that we've got a model that is going to be the envy of the rest of the industry. And I know some of you will probably be aware of this, but there are others who are talking mirroring our structure to enable them to compete more effectively. So it's nice if there are other successful operators to be added.

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

Neil Glynn from Credit Suisse. Just a question maybe for Stephen and Javier actually. To what extent are Ryanair's issues helping Aer Lingus and Vueling in the third quarter?

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

Stephen, do you want to...?

Stephen Kavanagh - *International Consolidated Airlines Group, S.A. - CEO of Aer Lingus*

To be frank, we -- third quarter, traditionally, we're operating at full capacity, so we are heavily booked so the opportunity from Ryanair's problems, isn't significant, it is on the margin. Longer term, I think you can see we're becoming a very competitive business. Anything that damages Ryanair is ultimately good for Aer Lingus, and we'll exploit that. But we'll do so by being disciplined in terms of continuing to take cost out of our business, continuing to be price competitive, and hopefully, the market will value the certainty that Aer Lingus will deliver.

Javier Sanchez-Prieto - *International Consolidated Airlines Group, S.A. - Chairman and CEO of Vueling*

If you look at the, let's say, the general ATC problems that are spread out in Europe, we're all suffering here and there. Ryanair is suffering the same, easyJet, Eurowings, everybody, so I don't think that we are -- any of us having a profit out of their problems of the rest. If you look at more precise way in the strikes they suffer lately, well, of course you can have a pickup the week that they're suffering a strike and they're cancelling flights in Barcelona but I don't think it's material.

Andrew Light - *International Consolidated Airlines Group, S.A. - Head of Investor Relations*

Any more questions? No? Okay, well, thank you, everybody, for coming. We'll speak to you again on the third quarter results towards the end of October, and hopefully, also on 2nd of November when we host our next Capital Markets Day at Heathrow.

Thank you.