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Market Intelligence

International Consolidated Airlines Group, S.A.

LSE:IAG

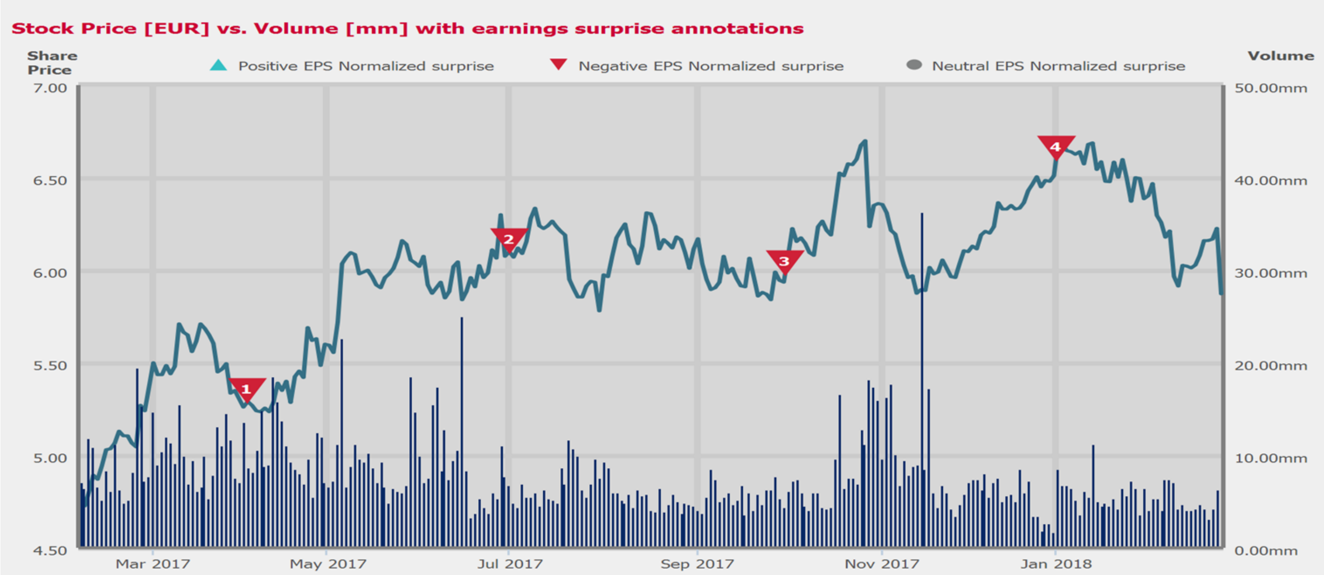
FY 2017 Earnings Call Transcripts

Friday, February 23, 2018 9:00 AM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2017-			-FQ1 2018-		-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	-	-	-	-	-	1.04	1.03	(0.96 %)	1.10
Revenue (mm)	5686.50	5467.00	(3.86 %)	5252.00	(2.39 %)	22977.15	22972.00	(0.02 %)	23867.64

Currency: EUR
Consensus as of Feb-23-2018 8:00 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2017	1.04	1.03	(0.96 %)

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Call Participants

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Chairman & CEO

Andrew Light

Antonio Vázquez Romero
Chairman

Enrique Dupuy de Lôme Chávarri
Former CFO & Executive Director

Javier Sanchez-Prieto
Vueling Chairman & CEO

Luis Gallego Martín
Chairman & CEO of Iberia

Lynne Embleton
MD of Gatwick, Director of Strategy & Director

Stephen Kavanagh
Former Chief Executive Officer of Aer Lingus

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Presentation

Antonio Vázquez Romero
Chairman

All right, good morning, everybody. Welcome to the result -- full year results presentation of IAG 2017.

I'm glad my colleagues here, Marc Bolland and Jim Lawrence, board member, are joining us here today. So thank you for coming.

We have seen an improved economic environment in IAG's core market along 2017 despite terrorist men and political issues in less extent and less [dramatic] than last year. It seems to be the people continue, will continue traveling. The ongoing Brexit situation, I will refer quickly, is, as I say it in the capital market day, we are confident that a comprehensive agreement, air transport agreement, between the EU and the U.K. will be reached. IAG complies with the relevant control regulations and ownership and control regulation, and we're confident that we will continue to do so even when the new regulations are coming into place in the U.K. on a post-Brexit scenario. The board and the management has been giving a lot of thought to the Brexit implications. We have done a lot of work. And we are in regular contact with all regulators and with the government. Willie will further elaborate on that.

As far the shareholders' return is concerned, as a result of the 3 quarter in 2017 was -- were presented, we did announce an interim dividend of EUR 0.125 per share. And I am pleased to announce that the board was recommended, is going to recommend a final dividend of EUR 0.145 per share. Altogether, these make a total dividend of EUR 0.27 per share, which means 15% higher than the one of last year's and is pretty much in line with the growth of the underlying [EBIT]. This demonstrate the board confidence in IAG's financial strength, strategy and the outlook.

I'm also pleased to announce that the Board of Director yesterday approved another EUR 500 million share buyback program 2018, which is same amount than last year. In total, IAG returns in cash to shareholder last year has been EUR 1 billion. And we do expect a similar amount or more in 2018.

I hand over right now to Willie -- or to Enrique for the management presentation.

Enrique Dupuy de Lôme Chávarri
Former CFO & Executive Director

Okay, so we are going to be jumping on the financial results. Good morning, everybody.

As it was already said and we'll repeat again, we are presenting a strong set of results, including an operating profit figure of EUR 3,015,000,000 for this year '17, which is EUR 480 million on top of last year's figure. And this represents an improvement of 19% in terms of percentage against year '16. And we have been basically achieving this improvement through a stronger set of revenues through the group. And revenues figures, especially in the unit revenue terms, have been improving since the first quarter. We were at the beginning of last year doubtful about the moment where we were going to be getting to breakeven in terms of unit revenues. Since year '13, we have been suffering of a long period of unit revenue reductions. We thought that it was going to be coming through the summer season. It was before. It was Q2. And it has been improving consistently through the 3 quarters of the year, Q2, Q3 and Q4. And you will see our Q4 figures in terms of unit revenues have been strong, very strong [indiscernible].

So it's also showed through a combination of capacity growth and passenger revenue growth. So capacity growth has been improving by 2.6%. RPKs figures have been growing by 3.8%. And that has been reflected in improved load factors [through] the different companies and improving and through the progress of the year.

In terms of ex fuel unit costs, we have increased our figures, nonfuel unit costs in constant currency terms, by 2.7%, out of which 0.6% has to do with increases in third-party businesses and revenues that are not strictly related to ASK. So the type of a -- like-for-like, apples-to-apples figure against last year,

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it's 2.1%. And this 2.1% has been very much related to some one-off and some type of consequences of our success. And I'll be going through those type of negative impacts later on in this presentation, but they are very much related, and I advance these concepts to you, with a significant swing in variable awards and bonuses for employees that are strictly related to the success in the performance of the business through this year. We have had also some one-offs, unfortunately, through the year having to do with the, I would say, June power off disruption in British Airways. We are also providing for some type of legal litigations and settlements that we are basically confirming through Q4, but I think a very significant message is the underlying trends in unit -- in nonfuel unit costs keep on being appropriate, keep on being favorable. We will be resuming the negative growth in nonfuel unit cost through year '18. And basically, we're still very focused in being able to improve the efficiencies on our businesses in this respect.

So talking more precisely on Q4. We've been reducing slightly the figure of operating profits for Q4 in respect of last year. There is a negative currency impact that explains significant part of the EUR 35 million, I mean, difference. And you will see that on a like-for-like basis the difference between the 2 years is just EUR 7 million. And it's basically very much related to the, I would say, bonus effect that we will be commenting later on. In terms of the revenue performance, passenger unit revenues have been improving in the last quarter of the year by 2.4%. It has been, as you will see, a very across-the-board improvement in terms of our companies and in terms of our different strategic markets. And this is not only related to premium traffics. It's also been affecting our leisure traffics as well. In terms of ex fuel unit costs, again the concentration on the bonus adjustments through Q4 is the one explaining that high figure that you are seeing and that we will be going through later on.

As I was explaining to you, Q4 operating profit has been reduced by EUR 35 million in respect of '16 figures. You make the currency adjustment of EUR 28 million. The net like-for-like and constant currency reduction is just EUR 7 million.

So in terms of performance, passenger revenue has been improving. And it has been improving not only in terms of the capacity growth, so you see the ASK improvement, but also in terms of the price mix. So that's the [unit] piece of the improvement. Also about passenger revenues, we have had a strong performance of cargo revenues specifically, and that's something that is flowing into year 2018 as well. It was the case in Q3. It has been even slightly better in Q4, and we expect to have a positive contribution improvement from cargo again through '18.

In terms of our cost base, we've had, I would say, the impact of increased capacity in fuel but also for the first time since '13 probably as well a slight negative contribution having to do with pricing with higher fuel prices, again, I would say, a small figure for Q4. And we're -- we'll be seeing smaller impacts through Q1 and Q2. I'll explain that afterwards. So ex fuel costs, of course the capacity drag and then very significantly the bonus impact that I'll explain briefly to you. So last year, '16, on top of post-Brexit environment last quarter of the year, most of the companies of the group realized they were not going to be able to achieve their targets. And then the winding of the accruals that were made through the rest of the quarters of the year, which reduced the base of Q4 '16 -- it's easy to explain. The base of Q4 '16 was [that is reduced by].

This year, the performance has been absolutely diametrically different, and it has been positive. So after Q3, it appeared very evident the companies and the group were going to be achieving their targets, even the Net Promoter Score target. So there has been a rebuilding of accruals in Q4. And the swing between the 2 years then, it's very remarkable. It's very material. It's in the range of EUR 90 million. So that is basically the one explaining this negative performance in the fourth quarter in terms of employee costs. Again bringing to you a little bit of comfort, the one that we have, the costs and pre-cost performance for the combined 2 years, so just smoothening the bonus impact, has been a net negative. So employee costs through '16 and '17 have been reduced in [unit terms]. And that's a very important [sign].

[Other supplier] cost increases, that we will be explaining with the [indiscernible] further on. And the ownership costs improving basically because of the combination of reduced depreciation and amortization cost and increased rental payments have been favorable this year -- this quarter.

Again on the revenue side, here is where I wanted to bring. This is a broader picture on how different the market segments and the strategic markets have been performing through Q4 very positively. So

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we'll get some more details afterwards, but it's good to envisage how both the premium, very strong premium traffic, but also the nonpremium and the long haul have been helping us in this in revenue increase. In the short haul, again strong performance for British Airways and Iberia. And as you would be expecting because Q4 is then, I would say, a weak season, a weak quarter for the more seasonable-pattern companies in the group, as -- Vueling and Aer Lingus is where there has been some type of minor reductions in unit revenues. But we are envisaging Q1 in again a positive way, and we are getting evidence of these unit revenue improvements been flowing into Q1 and Q2 of this year '18.

A little bit more of detail, a little bit more of flavor. This is a chart where we show our performance in terms of capacity and in terms of unit revenue in constant currencies. So what to notice is that the improvements that we are seeing are across-the-board, are in all of the geographies. Even the negatives that we have seen here in domestic has very much to do with capacity increase and stage length increase. So this has very much to do with growth both from Iberia and Vueling from the peninsula, into the Canary Islands, a very long-stage-length leg, which naturally and mathematically reduces unit revenues.

But having said that, North America had a significant 2.8% increase. And just to give you a little bit more of flavor: The performance of British Airways has been above 5%, very much aligned with the performance that you may have heard from the U.S. carriers, above its 5%. Of course, this is averaged down by LEVEL or even by Iberia, but even Aer Lingus has had a flattish performance in North Atlantic with a capacity increase of double-digit figures. So it shows North Atlantic is working very favorable for the group in terms of revenues but also in terms of contribution as well [indiscernible]. Latin America has been the star in this quarter. And it has been the star because of, even with a very significant capacity growth, has been showing a very impressive unit revenue performance. And that's both for British Airways and Iberia, both networks. And it's very much related on continental flights. It's not Caribbean. Caribbean went okay, but the south continental flights are the ones that are improving more significantly. And we are talking again on Argentina. We are talking on Brazil. We are talking on Mexico. We are [talking on Colombia], even Chile. So the new Chile and Santiago de Chile route for British Airways has been great, [yes].

And then the rest of, I would say, regional areas. Asia Pacific, also a very significant 3.7% increase in unit revenues, benefiting from the discontinuation of the Chengdu route last year; and improvements that we have seen, for example, for Iberia in Tokyo. Africa and Middle East, again I would say 2.3% unit revenue improvements on a growth of [4.6].

So the picture is good not only because of specific regions being strong but also across-the-board pattern.

And this is a little bit more of flavor again on the costs side, and this is having to do basically with the fourth quarter. And this is where you see the specific bonus swing affecting mostly to British Airways and Vueling; and being responsible for, I guess, most or very significant part of this plus 3.2% increase that we are seeing in the quarter. Again a little bit more of flavor on selling and IT: Selling has to do, of course, with specific cost decisions that are having already and that they will have in the future benefits in terms of revenue. And I'm talking about the new distribution model. I'm talking about marketing campaigns in the case of Iberia on their 90th anniversary. I'm talking about the decoupling about passenger figures in terms of growth and ASK figures. So our growth in terms of passengers and selling costs are passenger driven. It's significantly higher than the growth in terms of ASK, so that's basically behind these increases in selling costs that are having a parallel increase already in revenues. The IT, other is very much focused on a couple of issues, one-off issues. They have to do with litigations, settlements and provisions. It's basically having to do with [an issue with] executive-class litigation on fuel surcharges on one side. It's having to do also with a VAT litigation with Spanish authorities on international flights. So that's something that we have been preparing to be conservative about and we are covering our risks, but that's something that's very much related to the quarter, to one-offs. And that's basically explaining more than 2/3 of the increase in IT and other costs.

So again the message today is that what we are seeing is the underlying nonfuel unit costs that we want to keep coming lower on a year-to-year basis and that we have done so. Remember that, from the beginning, from the launching of our project, of our IAG project, we have been able to reduce nonfuel

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costs in 7 years by [10%]. So we are happy and convinced that we will be able to resume [a pattern of reduction].

And here is about fuel costs, unit fuel costs. And we are being again here conservative. We are taking today -- or last week market fuel prices. We are taking this reference of $650 per metric ton and a $1.22 per euro type of rate. And here is how it shows on our usual model, the usual chart. Basically, in euro terms there's going to be a very light reduction in quarter 1, also minor in quarter 2. Then it's going to be more in the range of 8% to 9% in Q3 and Q4 if prices, fuel prices, remain at the levels that they are today. Just a very quick "back of the envelope" calculation: So there's going to be on these terms a fuel bill increase in the range of EUR 400 million, EUR 450 million per year, out of which more than half is having to do with capacity increase, so the price-related costing is going to be less than 1% of revenue, around 0.7% of revenue. So again, we are worried about fuel prices. We are, I would say, focusing on our hedging instruments, especially focusing on the way we can obtain additional revenues, and we are convinced we will. The impact for the year is comparable to 0.7% in terms of unit [indiscernible].

So here we have our ROIC performance last fourth quarter for the different airlines on the group. So 16.0%, so this is record figure. It's record figure for the group. The figures that you are going to be seeing in the next couple of slides are record figures for each of the companies in the group. Very importantly, this 16% was 13.6% last year, so a very significant improvement.

Aer Lingus staying at 23% ROIC, which is a very impressive level but through a double-digit capacity improvement which is again even more challenging. British Airways is 16%, again last year 13.5% or so; very impressive figures as well. And worth to mention the improvement of Vueling. You will see in terms of operating profit figures they've been reaching 13.4% after a single-digit figure last year. And again, this is the consequence of a very efficient turnaround that the team in Vueling has been able to implement. So I would say, very confident and very satisfied of this achievement.

As you see here, operating results for Vueling -- or sorry, Aer Lingus, EUR 270 million, EUR 269 million, so EUR 36 million better than last year; in terms of lease-adjusted margin, 15.7%, so 1.4 percentage points better than last year. British Airways, again record figures in terms of operating profit, GBP 1,754 million, GBP 281 million, in sterlings, these figures are sterlings, better than last year; 14.9% lease-adjusted operating margin.

Iberia have come back strongly with an improvement in terms of operating results of EUR 105 million. So it's about 1/3 of improvement or 30%. Again, improvement in lease-adjusted margin 1.7, very significant. Maybe the star in terms of improvement, again, is Vueling this year, EUR 60 million, to 182 -- EUR 188 million, sorry; and operating margin, adjusted to lease, of 12.7%, improvement of 6%.

So really the performance of the group has been very important, very significant work [indiscernible].

Below the line. Below the line, we are disclosing an improvement of 14% in underlying EPS. So that's totally dilutive and pre-exceptional and which we'll be translating into a growth on dividend per share of 16%. So basically worth to mention the reduction in net finance income and expense. So the real underlying financial -- net financial costs have been reduced and very significantly because, as you will see, the size of our in-balance-sheet debt, both gross and net, have been improving very significantly. Some swings against last year on these other concepts, which is basically aggregating a very heterogeneous basket of things. Relevant there then, I would say, gains and losses on disposals. So last year, we had a capital gain, a remarkable capital gain, on British Airways on the disposal of our A319 fleet. And this year, we had some minor losses, so significant swing there. Significant swing also on the, I would say, valuation of ineffective hedges. That's going to be changing now through our new IFRS regulation. We are going to probably reduce very significantly the volatility that we will be recognizing below, I would say, the operating profit because of this concept. And this has to do with time value recognition that's going to be treated in different ways. So hopefully, we will be able to reduce up to some [stages] this volatility below the operating profit line. There will be some less -- some remaining ones having to do, for example, with pension accounting which as you know [below the line].

Taxes. Effective tax rate of around 19% this year, very much in line with last year. So profit after-tax of EUR 2.243 billion; and an improvement in fully diluted earnings per share, as I was mentioning, of 14%.

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A little bit of our summarized financial structure. As I was mentioning, gross debt has been reduced not only because of the gradual repayment of our financial leases but also because of a repayment of some of our funding in British Airways and the group that happened through 2016. So on balance sheet, net debt is now EUR 655 million, again showing a very strong balance sheet. Of course, we always adjust it through our -- what we call the notional level of our operating lease liabilities. These figures will be changing through the adoption of IFRS 16. As you know, the new accounting standard then will be recognizing in balance sheet those operating lease obligations as then, I would say, the value, the net present value, of the committed rentals payments through time. And we hope the final figures that we will be bringing into our balance sheet are not going to be very different to the ones that we are showing here on a more simplified basis.

So adjusted net debt-to-EBITDAR and improving again this year. And this is, of course, before what we intend to do in terms of this new share buyback, EUR 500 million, that we've announced the intention of the company, the group to execute [through FY '19].

So cash flow. Again, on the top of the chart, we are showing how we have been retributing, how we have been giving back cash to shareholders both upon the results of '16 and then upon the results of '17, what we intend to do. So on the results of '16, the board and then the shareholder assembly decided to distribute EUR 495 million, and then the share buyback of EUR 500 million. This year, we are proposing a final dividend of EUR 0.145 per share, subject of course to the approval of the general shareholder assembly; and a share buyback program of EUR 500 million. We'll be then above EUR 1 billion of cash being returned to our shareholders. And that, we can do so because we will be generating, we have been generating significant amounts of cash.

So in terms of operating profits, you see the EUR 500 million improvement. In terms of EBITDAR, it's about EUR 400 million improvement; and then in terms of equity free cash flow, again something in range of a EUR 400 million improvement, leading us to an equity free cash flow generation of EUR 2.7 billion per year, which is as you'll remember probably above the average of the plan. The average of the plan is EUR 2.5 billion. As you know, the year-by-year figure is heavily influenced by delivery dates on our fleet renewal program. So we are going to have ups and downs. This year has been benign. Next year, we are going to have more -- this year, sorry, '18, we are going to have more fleet deliveries, so that will represent probably a lower figure. But again, I would say, very comfortable in terms of coverage of our future share and -- buyback and share dividend [commitment].

And then this is again good news. We are not going to be very explicit about figures, but as a whole, it's a very positive message. As you know, because we've been public about it, British Airways team has been engaged since the beginning of last year working on a new pension fund scheme that could represent a reduction in the exposure and the vulnerability, financial vulnerability, of their balance sheet and their accounts. So this means basically closing for [our] future accruals the famous NAPS scheme; and integrating the BARP scheme, which is a -- it is already a defined contribution model. So both of them should be embedded in a new one that the team has been working and defining and discussing with employees and unions. So there has been a very, very intense work being done to convince unions, to convince employees to transmit information, to put the systems ready in the company, to engage the employees into the new system.

And the latest news on this area are positive because the ballots that both -- on a consulting, a consultative basis that both BALPA and united (sic) [Unite] have been performing have been resulting in positive votes from employees on their engagement with the new schemes. And there is still a formal -- it's not only formal. It's a real, I would say, final step that has to be undertaking by the pension fund trustees to approve their migration into the new model and the actual closing for accruals of NAPS. And we are expecting to get that one by the end of March. So that means that, since the beginning of April, cross fingers, hopefully, we'll be able to open a new defined benefit -- defined contribution, sorry, scheme for all the employees both engaged in NAPS and BARP. And that will have positive implications in terms of exposure, in terms of vulnerability into the future and that we have a reflection in both balance sheet and profit and loss account. It's very early to talk about numbers. We are not going to be talking today about figures because the transition into the new model will be one that will have choices for employees, choices about how much they would be receiving as a lump-sum cash payment; of how much they would want

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to be, I would say, included into increased contributions into their future plans. So that's something that probably we will be getting more information through March and we'll be ready to explain and transmit and share with you once it's [final].

So giving back...

William Matthew Walsh
CEO & Executive Director

Thank you, Enrique.

I get to steal Enrique's normal slides and the outlook page.

So [comparatives] comments. I think 2017 was a very good year, and we're building on that for 2018. And we believe that -- at current fuel prices and exchange rates we expect our operating profit in 2018 to show an increase year-on-year significantly, we believe, for our passenger unit revenue and ex fuel unit costs are expected to improve at constant currency. And so 2017 was a good year. We said on the front of our annual report and accounts that the best is yet to come. I'm saying that again today because there is more to come in 2018 and beyond.

If we look at capacity increases for the year, the headline figure of 6.7%, you can see that that's a contribution evenly split across the operating companies. I'd like to point out again we are not a legacy carrier. British Airways is probably the most legacy of our carriers, and the growth at BA in 2018 will be about 3%. 0.6% of that 3% comes through the acquisition of the addition of [bulk] at Gatwick from Monarch. The Iberia contribution of 7.5%, some of that is fourth quarter loaded. And it is a base effect here because Iberia had 2 aircraft grounded in Q4 of last year for retrofit, putting in the new [products] in the premium economy in the aircraft. We got 1 aircraft down this year. And LEVEL obviously will continue its growth. And I'm going to talk about LEVEL later on, but we have already announced 3 additional aircraft for LEVEL in 2018, 1 of those aircraft in Barcelona and 2 in Paris Orly.

Now I think the distribution of that capacity growth is important. And this is a regular slide that we show you. And you can see there that we have a number of new routes that we've already announced, with Aer Lingus continuing its strong growth on the North Atlantic, which has been extremely positive, yes, for Aer Lingus. And we are very confident that, that can continue. In fact, there's quite a lot of opportunities in the future for Aer Lingus. We've talked previously about the A321neo LR, which they will take into the fleet in 2019. And clearly, we'll talk more about that at Capital Markets Day later on this year. Some new routes for British Airways, one for Iberia. I'd really focus on the like-for-like changes because what you can see there is that a lot of this comes from frequency, particularly at Vueling. And this is absolutely consistent with the strategy that we highlighted to you as we went through 2016, that Vueling was going to focus very much on the quality of their network. We believe we spread ourselves too thin during 2015 and 2016 as we went through growth there. I think that the team have done an outstanding performance [indiscernible] 2017, evidenced by not just the operating profit but also the punctuality and customer satisfaction scores. There's been a huge turnaround for Vueling, and I think it's great testament to the group.

So what they've been doing has delivered very strongly in 2017, and we're building on that in 2018 with a clear focus on the quality of the network that we have; having regular, frequent flights in key destinations, principally from Barcelona; but also building on our hubs at Rome and Paris. So we believe this is very sensible. We have focused on growth where that growth is accretive. That's an important point. 6.7% headline ASK growth, but with unit revenues improving year-on-year.

So how are we doing all of this? I've said before I think we are unique. And we're not legacy. We have the advantages of legacy. We have the knowledge of legacy, but we're new in our thinking. We're flexible. We're innovative. Our structure is unique. And I'll point to some of these issues in a second, but what we get is a financial performance that in 2017 exceeded our targets. And Enrique mentioned that return on invested capital of 16%, above our 15% target; lease-adjusted margin 14.4% and the range 12% to 15% that we've highlighted investing in accretive organic growth. We're always open to the opportunity for inorganic. I think what we've done to date has been very successful. The acquisition of bmi and the folding

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of that operation into BA at Heathrow, the acquisition of Vueling, very successful acquisition of Aer Lingus, the recent acquisition of slots at Gatwick, all of these are very positive for us.

So that performance leads to our equity free cash flow of almost EUR 2.7 billion, as you've heard Enrique say, above our target through the plan of EUR 2.5 billion and generating cash for our shareholders; EPS growth of 14%. That sustains our regular dividends, clearly. And as the Chairman mentioned in his opening comments, we announced our intention to complete a EUR 500 million share buyback in 2018, similar to the 2017 share buyback.

The figures are clear. We have a focus on generating cash and using that cash to invest in the business where it's accretive to our growth. We will sustain the regular dividend. And further is surplus cash. We will return that surplus cash to our shareholders. We're not going to use this. It is absolutely consistent with what we've been saying. If we're not going to use it, and that cash will get returns. The only question we've had in the past is how we return that. And clearly, we believe that share buyback is the right thing to do. We successfully completed the share buyback in 2017, 3.5% of shares outstanding. That was well executed. And in 2018, as I mentioned, we intend to repeat that with a EUR 500 million share buyback.

Now our strong platform also is built on a clear focus on cost efficiency. And since we created IAG in 2011 -- and you can see the chart here. Reference base is 2010. In constant currency terms, you've seen our ex fuel unit costs decline by 10.3%. And there is more to come. There will be some hills in this. It's not a roller coaster. There are times when we have to address some cost issues and invest, but we have a clearer path through the next 5 years of our plan that will see us reduce our unit costs further. And we'll do this through further synergies from the growth platform which has been very successful and improving: the Iberia Plan de Futuro II, which is in [train]. Vueling has an ongoing focus on their cost efficiency. And Aer Lingus will continue doing what they've done and doing it extremely well. So we are focused on cost reduction. I think that's been very effective. We will continue to do that. And we're very confident that, for the period of this plan, we will see a further reduction in our unit costs. And this is well in excess of anything that our competitors have done. We will continue to move at a pace that is better than our competitors'.

LEVEL has been fantastic for us, and I think it demonstrates the flexibility of that unique model that I've talked about. What we get through IAG is a focus on capital discipline that doesn't exist in other groups because we don't favor one airline. We favor the efficient airlines. And we have great competition for our capital. That clearly creates a much more efficient group, but in LEVEL we see a strategic opportunity. You've heard me talk about this segment [of the market] at length. We think it is a segment of the market that can be exploited successfully by IAG. We are encouraged by what we've seen so far, very encouraged indeed. We launched LEVEL out of Barcelona on the 1st of June. It was a board decision in February announced on the 17th of March, launched on the 1st of June; shows the flexibility, the innovation that we have in IAG, our ability to move quickly and adapt to new opportunities. We launched the year ahead of plan because we saw the opportunity at Barcelona. We're building on that with the addition of another aircraft. We're changing the network. We operate at Barcelona to Punta Cana. We learned a lot from that. Punta Cana is principally a market that is important to tour operators. So rather than Punta Cana, we're going to switch to Boston. And out at Paris, we've launched LEVEL, which will, I mean, see us using the OpenSkies platform. So that will be transformed into LEVEL. And we've announced the first 4 groups with 2 aircraft based at Paris to Montréal-New York, Guadeloupe-Martinique. Our plan in the short term sees us getting to about 15 aircraft but with the opportunity to build on that. We're using the A330-200, which is a very efficient platform for us, 293 seats, 21 premium economy seats, very efficient structure. Unit cost performance of LEVEL has been better than our expectations. The 5 aircraft, the 3 additional aircraft will also be Airbus A330-200s, but we do have opportunities to switch to the 787. And we are in discussions with both Boeing and Airbus about the future aircraft for LEVEL.

This is the unique structure that we have because we can use multiple AOCs to provide the lift for LEVEL. We have 787s in the group already, so we have the experience of operating with these aircraft. And we have the flexibility to use them. So LEVEL, as I said, has exceeded our expectations in terms [of performance]. And we believe there's a lot of opportunities for us. It gives us significant advantages over our competitors, shows the flexibility of IAG. It proves the plug-and-play platform that we have, that we can get this airborne, get it working very quickly and get it working very efficiently.

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Now a lot of talk about Heathrow. And we're very clear that we would support the expansion of Heathrow. We think there is a strong economic case to be made for Heathrow but only if the [cost is right]. We're very much focused on the national policy statement. And we want to see a hard measures included in that because that will hold Heathrow to some of the promises that they've made. They've made lots of nice promises. If you were a naive, foolish person, you would believe them. We're neither naive nor foolish. We don't believe them. We won't see this guaranteed. We think there is an opportunity at Heathrow. We think the airport can be expanded without any increase in passenger charges. We've shown Heathrow how we would do it. If we were responsible for the expansion, and we believe it is possible for them. They don't have the incentive to do this in an efficient way because, as you know, the regulatory structure has rewarded their inefficiency. And that's unacceptable to us. It's been unacceptable. It continues to be unacceptable, but we're not going to tolerate it. And therefore, we will continue to argue very strongly our case that this should only proceed if there is a hard commitment to maintaining passenger charges. We see no reasons why customer charges should increase. We're not in any way impressed by language that, "We're trying to keep them close to the existing charges." That's not good enough, and we believe it can be expanded without any increase.

The expansion would bring these slots to Heathrow from 480,000 to 740,000. The secretary of state has said he would like to see 15% of those new slots, about 39,000 slots earmarked for domestic growth. And I think that's an interesting concept he pointed out at the Transport Select Committee. The domestic network that Heathrow uses about 8% of the existing slots at Heathrow, around 39,000 thousand, 40,000 that would, in fact, be a doubling of the slots used for the domestic flights at Heathrow. We believe that that's -- will only work if the airport charges deeply because we can't see any incentives for carriers to come in and operate domestic flights. And if the charges remain at their current levels, there'd be no possibility if charges were to increase. And that includes the existing domestic network that we have.

And Heathrow have said they can do this for GBP 14 billion. We think that price is still excessive. So if it's efficient, we will work with them. The timetable, as you see, has been set out. And there's a lot of consultation. I take comfort from the fact that John Holland-Kaye is obsessed with the comments that I've made. To quote Oscar Wilde: He said that "Whenever people agree with me, I always think I must be wrong, but the fact that they're disagreeing with me means I'm right." And we will continue to argue the case very strongly. And I'm pleased that other airlines have sided with us in terms of what needs to be done at Heathrow.

Now the Chairman has outlined all of the comments that I wanted to make in relation to Brexit. We are evaluating all of the changes that we believe can be considered to ensure that all of our airlines within the group [continue to profit]. It is interesting to say that a number of airlines who have responded to this issue have put in place a structure that we already have in place. And they say that, that ticks the box, that they're now able to provide assurance. We already have structures in place. And clearly, we're flexible in terms of adapting those structures [effective]. We do remain confident that a comprehensive air transport agreement will be agreed between the EU and the U.K. We're certainly very pleased with the [discussions that] the U.K. government [indiscernible] with others. Particularly, the U.S. feedback we've had obviously has been very, very positive. We have had extensive engagements with all of the relevant regulators. We will continue to do so, and those engagements will continue over the coming months. [indiscernible] been very good discussions with the regulators. We've got a good relationship with all of the relevant [regulators]. And we're confident that we will comply with U.K. ownership, controls that are regulations; and EU ownership and control regulations as they will be structured post Brexit.

It's important to remind people IAG is a Spanish company. We have long-established airlines in a number of countries with substantive businesses, sensible places of business. So Aer Lingus is in Southern New Zealand and Ireland, principal places of business, while Iberia is in Spain. Vueling is in Spain. British Airways is in the U.K. LEVEL in Spain and France. We employ over 60,000, nearly 64,000 people right across those countries. We're operating 546 aircraft. As I mentioned, we have structures and have protections in our bylaws that have been in place since we created IAG in 2011.

And we're going to continue to make progress. I think a lot of positive work done during the year. And the structure of IAG is one where we control the capital at the center and control of capital-controlled capacity because we'll only allow capacity where we see that capacity being sensible and accretive. That

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provide our shareholder the assurances that our shareholders need and demand. And I think that others don't get that we're not going to pursue capacity growth that is ill disciplined. Capacity growth [will be simply] very, very sensible. Go back and look at that chart, building on the strength of our own network to be sure that we continue to have a leading position in our core markets, building on the strength of our network across the North Atlantic and across the South Atlantic, taking advantage of the economic upturn in some of the key economies that we serve, using LEVEL to exploit a completely new segment of the market. The fascinating thing about LEVEL with the expansion out of the Barcelona is we've not seen any cannibalization. It hasn't in any way impacted on the Iberia traffic out of Madrid. So growing the leadership position. We have strong brands that we have. We're doing a lot of work now at IAG at better understanding how we can exploit our brands, not controlling the brands from the center. That's still the responsibility of the operating companies but ensuring that we can use the brands in markets to their best effect. And that's something you will see more and more as we go through 2018, building on the success [maybe] as it is, becoming real plug-and-play. And I think the evidence of that, if anybody questions us, is how can you get an airline that you make a decision to launch in February but you announce them the 17th of March and get them airborne on the 1st of June? That shows the flexibility and the strength of the platform that we have.

So that unique structure gives us the confidence that we can continue to build, the confidence that we will continue to innovate to respond to any challenges and opportunity, to build on the brands that we have, to continue to reduce our ex fuel unit costs with structured programs in all of the airlines. We're pleased to have exceeded our financial targets in 2017, better returns than 2016 with more that we will do in 2018. Remind you what we've said, current fuel prices, third quarter, Enrique said about the fuel price and exchange rates, we expect our operating profit to increase in '18 over '17. Unit revenue and unit costs improving through the year.
So a confident, strong position. I'm excited about the opportunities for 2018 and beyond. With that, I'm going to hand back to Andrew, who will manage the Q&A.

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Question and Answer

Andrew Light

Thanks very much, Willie and Enrique. We're now ready for questions. So David and I have mics. We're not using the big microphones.

James Edward Brazier Hollins
Exane BNP Paribas, Research Division

It's James Hollins from Exane. Three, please. I was just wondering if you could give us some detail on Q1 RASK. Are you seeing similar trends to Q4? Any numbers on that would be great. Secondly, on the ex-fuel CASK outlook for full year '18. I was wondering if you could say that would absolutely be down still if you took out the benefits of the potential pension change at BA. And the third one is, the wolves are at your door on promotion on more specifically Net Promoter Scores. I was wondering if some of the detail we're seeing in the media, maybe this is for Alex, would suggest that there's a bit of negativity around the BA brand. What are you seeing internally in terms of NPS, in terms of your own view of what the customers are saying, either for you or Alex?

William Matthew Walsh
CEO & Executive Director

Let Enrique address the first 2 questions and then I'll jump in.

Enrique Dupuy de Lôme Chávarri
Former CFO & Executive Director

Yes. So unit revenue, early signs that we're seeing for Q1 '18 are basically following the positive trend that we have been announcing. Again, we will have to evaluate Q1 with a -- say, with a grain of salt because it includes Easter, okay? And last year was different. So including Easter, we're really comfortable and we are encouraged by the early signs. And we're seeing -- and there are early signs on January and -- of course, March, Easter. It's growing and it has to grow. But even January and March, the signs that we're seeing, early signs are positive and following positive trend. The second one was?

William Matthew Walsh
CEO & Executive Director

Unit costs.

Enrique Dupuy de Lôme Chávarri
Former CFO & Executive Director

So -- yes, unit cost into '18, again, recovering, I would say, positive. So negative unit trends. Of course, we'll be able to disclose impact of new pension fund schemes [indiscernible] [this year] was later on. It's going to be positive. We're not going to be announcing today any figures. But apart from that, we are following, I would say, the plans that we've been engaging in for the last couple of years. For example, we are, as you know, considering some of our labor costs has been exceptional, both in British Airways and Iberia because they are basically attending these famous 2 projects. So in the case of British Airways, it's project Athens. And project Athens is going to have -- maybe Steve, you can give a little more flavor on that one.

Unknown Executive

And do you want to comment on the pension as well? I think it is important to say that we still have a deficit, which needs to be managed. So that the deficit doesn't disappear if the trustees [indiscernible] -- the trustees, we've got to consult with the trustees, and we don't want to get ahead of ourselves here. That has to take place and reach agreements with the [indiscernible] do you want to comment?

Unknown Executive

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A few comments, really. I would still expect the nonfuel unit costs for BA to be down next year even without the pension benefit going through. So, that's the direct answer to the question, James. In terms of the second half of this year, we did slow down on some of the project Athens stuff because we did want to get through the consultative ballots, as you can imagine, you don't want to do too many things sequencing and phasing is important. So that's one of the reasons the restructuring program went into 2018. So there's still lot of work to do in 2018. So we've got a lot of plans -- we did a lot in 2017. We changed a lot in the engineering basis and we changed a lot in the terminals as well, but there's plenty more to do. So to reiterate what Enrique said earlier, is we're still very, very focused on nonfuel unit cost and there's still lot of plans to deliver it in 2018.

William Matthew Walsh
CEO & Executive Director

In terms of NPS [and I'll ask Allan -- Alex to comment, but my observation of it is that the performance in BA in the fourth quarter was very encouraging. We know that the NPS was impacted by the decision that were taken. I mean we knew there would be. Some of the measures we took which are designed for future proofing British Airways, we knew would have a short-term negative impact. We've seen it. We've made some of these changes in Aer Lingus. We knew what the impact would be. We made the changes in Iberia. We could see what the impact -- of the changes we've made in BA. We knew what was happening there. BA did face then some extraordinary issues, which impacted on the NPS, but the recovery in the fourth quarter -- I don't know Alex if you have a microphone there, the recovery in the fourth quarter was great. Part of the issue in relation to the bonus that Enrique spoke about and what we're seeing so far this year is very, very good. So I'll let Alex speak and then I'll tell you what I'm going to do in terms of targeting Alex for NPS [indiscernible].

Alejandro Cruz de Llano
Chairman & CEO

Looking forward to that. The -- so very quickly to extend what Willie was saying, the NPS has been evolving positively underpinned by a fantastic performance operation. So the increases in punctuality and baggage performance have been a tremendous underpin for positive evolution of NPS. And that positive evolution continues across January and February, et cetera. The only detail I would give you is, as we go to market with new features, product features, call it the new economy class, long haul, catering, as we roll out the Club World catering and bedding, we see specifically and very visibly increases to NPS. We have a lot of that coming throughout the whole year, as we explained to you at Capital Markets Day. So we are very encouraged by the early signs of the evolution of NPS, more investment as it translates and it goes live. We are convinced that it will deliver further increases and of course, underpinned with what looks like still very good and operational performance with an opportunity to improve even more. Thank you.

William Matthew Walsh
CEO & Executive Director

So as you know, James, the league can be won or lost in the run up to Christmas, the early performance in January. And I have to say, based on the performance of BA, that leads into Christmas and through the early part of this year. So it's definitely looking as a very good performance. And Alex will be tasked with even beating the targets that we've already have agreed [indiscernible]. So we expect even better performance. But it's very encouraging, and it is important to reflect on the investments that we are making, which are designed to generate [RASK and] [indiscernible]. But the changes, and I make no apologies, the changes we have made, we've made so that British Airways will be competitive in the long term. You have to go through some short-term turmoil to get through that, and we're getting through that. Very encouraged by it.

Jarrod Castle
UBS Investment Bank, Research Division

It's Jarrod Castle from UBS. Firstly, just on staff. Obviously, the likes of Ryanair are seeing wage inflation, some of the other airlines. At this point in the cycle, it is going to be a case of, please sir, can I have some

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more so to speak from your employees? And secondly, just on the buyback, EUR 500 million is a good number, but could you have done more and why not? Or do you just think that is the magic number, EUR 500 million, each year? And then just lastly, a quick one on high-speed rail and the launch from London to Amsterdam. What that does or doesn't mean for British Airways, et cetera?

William Matthew Walsh
CEO & Executive Director

Okay. I think what Ryanair is facing is unique to Ryanair. Stephen would like to comment on the negotiations that he just completed with pilots in Aer Lingus, very close neighbors to Ryanair, but those negotiations have been ongoing and they -- we got a result from an independent arbitration board. I think it is -- Stephen if you [indiscernible]

Stephen Kavanagh
Former Chief Executive Officer of Aer Lingus

We've just completed effectively a 3-year deal with all labor groups, with pilots specifically. It's 11% of total over 39 months, 8.5% award and the balance associated with productivity, which is a one-for-one. So across the other labor groups, the 8.5% was the award. So we're very comfortable in terms of the levels of productivity that we can drive out of the business on an ongoing basis. That's not only affordable, but that underpins our nonfuel unit cost opportunities in the next 3 years.

William Matthew Walsh
CEO & Executive Director

Stephen, -- the one thing I would say is we're not seeing any difficulties in recruiting pilots at the moment. I commented on this before. There's talks of pilot shortage. I don't see it. I think we've got some issues that are evident in terms of the number of captains that are available, but we don't have an issue. We haven't seen this in any of the airlines so far. The market is a bit more competitive really, but there's still plenty of supply in the market side. We don't have any concern based on what we're seeing. In relation to the share buyback, EUR 500 million last year, we have an intention of EUR 500 million this year. That sounds like it's now there and it's firmly established. Clearly, the share buyback makes sense and we set out the criteria we would use to decide whether the share buyback would be the right thing to do with it. We believe it's very clearly the right thing to do given where our share price is today. We'll always look at how much and that's a decision that the board will take, but I go back to what I said. Our intentions with regard to excess of cash are very clear. We'll invest cash in the business where that cash will generate additional returns for our shareholders. We will look at inorganic opportunities where we see opportunities. We want to be positioned to take advantage of that. We're not actively involved in anything. As you know, we were very actively pursuing NIKI. But great credit to Javier for walking away from that deal because he had a clear view as to the price he was prepared to pay that would generate value for us. And for -- professional enough to not get into a ridiculous bidding war. So somebody want us to pay more for that, great. The advantage for us is having seen what the market is like there and established a clearer understanding of present IAG. It's now looking to do something organically in Austria. We will decide which, how many of our brands we'll use to do that. But we see a market opportunity that we can pursue organically, and that's the beauty of it. We understood what the benefit of the inorganic was. And we can see the benefit of organic, and we will continue to do that. And if we have excess cash then the board will discuss that and conversations [indiscernible] I've said it before, those conversations are very clear. We will use the cash sensibly if we can, and if we don't see a reason then that cash will be redistributed [indiscernible] the form of the redistribution will be [indiscernible] share buyback.

Neil Glynn
Crédit Suisse AG, Research Division

Neil Glynn from Crédit Suisse. Can I ask 3 questions? First one that I have, focused on the 2018 guidance. Obviously, the new distribution strategy is still very, very young. Is there anything within that guidance at this point? Or is that a free option for '18, maybe hoping for more beyond as you build the strategy? And the second question on the Monarch slot. I think all -- or certainly most or all are being used on short haul this year. Over the medium term, how much of those should we expect to migrate to long haul? And then

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third question, maybe for Lynne, I see she's been sitting here, on the cargo side. I think it was just over EUR 60 million of cargo incremental revenue in 2017. I guess most of that probably dropped through to the EBIT line given strong global trade flows. Can we expect a similar performance in 2018?

William Matthew Walsh
CEO & Executive Director

I'll let Lynne address cargo. I would say, it was a record set of performance for cargo that's why we didn't highlight it in the presentation, but Lynne gets great credit. She went in with cargo, faced some challenges and produces a record performance. So well done, Lynne, and no pressure on you for 2018.

Lynne Embleton
MD of Gatwick, Director of Strategy & Director

All right. On the 2018 outlook, so we certainly saw the market strengthen as the year went on in 2017 quarter 4, the demand was fantastic. So we actually saw a lot of that revenue come through in yield in quarter 4. We're very conscious of where the fuel price is, and so as we've gone into 2018, we're trying to make sure that we can [indiscernible] to not let the fuel price damage [the division.] So, so far, we're seeing the market performing very strong. We know that the cargo market is very volatile. So I would like to get a crystal ball out and predict how the full year looks. But we feel we're in a strong position to take advantage of the market [indiscernible] market condition [indiscernible].

William Matthew Walsh
CEO & Executive Director

And while you're standing, because you used to run Gatwick, and I'll ask Alex to comment as well, but you want to give a view as to how you would see Gatwick developing [indiscernible]?

Lynne Embleton
MD of Gatwick, Director of Strategy & Director

Indeed, had I still been running Gatwick, I would have been delighted to get hold of the Monarch slot. I think it's a fantastic opportunity to get [British Airways] there, both the short haul and the long haul performance at Gatwick has been strong and giving the kind of financial returns that shareholders could expect. We do see plenty of opportunities to grow long haul business. But there are opportunities in the schedule to strengthen the short haul business as well. So, I'm somewhat envious of Alex's opportunity to make the most of that portfolio.

Alejandro Cruz de Llano
Chairman & CEO

And not a whole lot more to add. Certainly, the focus this year is the short haul. It's very, very difficult to procure or to consider any other options other than short haul. So you'll see increase of frequencies to well-known destinations. And we are kind of thinking what is it that we will do next year, and of course, aircraft availability and such continues to be a big issue. So nothing much to comment on. Very big focus on '18 short haul. And as soon as we come up with ideas for what we can and cannot do for '19 onwards. But certainly, in terms of ambition, to be able to take a look at options to continue to grow, a very, very, very successful long haul network for Gatwick is definitely possible.

William Matthew Walsh
CEO & Executive Director

On our new distribution strategy, very pleased with the introduction [indiscernible]. The point we need to make here is it's a cost initially, and in fact, it's behind some of the cost increases that we're seeing, and that will continue to be the case. As you know, the move away from the deals that we had with the GDSs. So paying higher rates to the GDS. But the long term is very positive, and this is an investment in a long-term change in our distribution strategy, which will see us continuing to work with the GDSs where it's sensible to do so. And I've been very clear about that. We want to have a relationship with the GDSs, we believe they still have a role to play, but not the way it was played in the past. So the changes have been very well received. It's performing better than we would expect it. We are seeing a very healthy

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improvement in our direct distribution. And direct distribution for us is much cheaper than distributing through the GDS folks. The short-term issue here is the cost issue, so our cost's increase. That's one of the headwinds that we face, and Enrique mentioned. But over time, it's the right strategy. And this is ultimately a revenue strategy, but it's one that we'll see as, it being distribution cost increases.

Unknown Executive

And the breakeven in the equation that Willie was mentioning, it's coming, I would say, earlier than we thought. It's going to be coming through '18, and that's very [indiscernible].

William Matthew Walsh
CEO & Executive Director

And we will talk -- we'll give a lot more detail at Capital Markets Day because we'll have 1 year of operation of the new distribution strategy at that stage, but what I would say is the initial response in all of the airlines has been better than indiscernible].

Mark A. Simpson
Goodbody Stockbrokers, Research Division

Mark Simpson from Goodbody. A couple of questions, one for Alex, Plan4, just understand where that's at, I think being conservative on EUR 50 million of costs associated with that program over the last 2 years. So wondering how that score plays out, but specifically at BA and on the cost front. LEVEL, I think you've mentioned in the past just the surprise to the upside was how strong ancillary was on a per pack space. Wondering if you could give us a bit more detail about how that's being played out. And then finally, North Atlantic, Japan, markets where the long haul capacity is originating from those markets are unhedged. I assume looking into the summer that the concept of either you call it a fuel surcharge or a price increase, that we'll likely to maybe see there's markets benefit from that change?

William Matthew Walsh
CEO & Executive Director

On Japan -- well, in Japan, as you know, it's regulated from the pricing point of view and maybe domestic Japanese carriers -- the Japanese carriers putting through fuel surcharges. It's not a structure that we particularly like, but in some markets that is the structure in the market and I think you will see more of that. And we share your view that with the U.S. carriers currently unhedged with the increase in the price of oil. We would expect them to seek cover by the increase. In fact, I was encouraged by some of the comments, particularly that Delta made where they talked about the industry's ability, exactly as we have. The industry does recover it in time. It's much shorter today than it used to be 5 years ago. And the view that was being expressed by them is that period of recovery is short term [too]. So that points to support what it is we've been saying that the industry responds much more rationally to these issues, and we expect that to continue to be the case in 2018. Not everybody does that in a way that we would describe as maybe rational, but the industry in the main, certainly, that's what we're seeing. With LEVEL, yes, ancillary -- we'll focus on ancillary later on this year, it will be a feature in Capital Markets because we're doing a lot not just in LEVEL. But we're learning from what we're seen. But what we've seen in LEVEL has reinforced our view that this new business model of low-price seats where the customer gets a choice, we give the flexibility to the customer to decide what it is they want. And, you make it easy for them when they are aboard the aircraft to buy products that they want to. So the way we do it, as you know, on LEVEL is through the screen. Very efficient, works extremely well. I do have a video. I don't know if it's on our website. So how it operates on an Iberia flight [indiscernible] we show it internally. We should certainly make it available, but we will do a lot of this in Capital Markets Day because some of the learnings from LEVEL we're applying to other processes. Aer Lingus, as you know, has introduced a new fare structure and they would see genuine focus on retail revenue. That's very much their focus [indiscernible]. We are learning a lot and clearly, the technology has improved a lot to enable us to do this more efficiently. And Alex, do you want to comment on Plan4?

Alejandro Cruz de Llano
Chairman & CEO

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So very quickly, Plan4 was the name that we used to put in the 5-year plan and it involves 4 pillars. So it's customer, operations, efficiency and people. So everything that you've seen that we talked about at Capital Markets Day last year was part of -- mostly was part of the customer, our proposition and investment that was going to come behind it. operations, I talked about it before. A tremendous emphasis behind increasing operational excellence from punctuality, baggage, cleanliness, et cetera. The last one is people, and that involves all the different programs that we have internally to deliver -- manage to deliver better experience overall for our customer. Yes, [third] one is sufficient. And we are, as Steve mentioned earlier today, we are on track to continue delivering all the different initiatives within the efficiency and cost reduction for the year. You will see that as we go along. But again, very much on track over 200 different initiatives. Plan4, more than just cost, because cost is just one of the [indiscernible] that's on track.

[audio gap]

I think the guidance that we've provided that there's going to be a positive evolution both on unit revenues and unit costs. And I think that's always [tandem].

William Matthew Walsh
CEO & Executive Director

[Pete] do you want to comment on that?

Unknown Executive

Yes, 2/3 -- 3/4 of way through that program in terms of sectional cost guidance coming through. So there is a -- still a chunk that will come through in 2018. But as I said, we did slow down some of the plans in 2017 given what else we were trying to do at the time. So that's why it's gone into 2018.

Andrew Lobbenberg
HSBC, Research Division

It's Andrew Lobbenberg from HSBC. Can I ask about LEVEL and what the timing is in terms of structuring it organizationally and how you're going to run with multiple AOCs? And equally, how it blends in or doesn't through the joint business agreement [How American sees it]. Can you talk about Italy and the option to take advantage of what may or may not happen with Alitalia? And then, could I just ask around the Monarch slot take up at Gatwick. How are you handling that operationally? Because I think there was an application to bring in some Qatar planes again. But how are you going to fly those and what impact would that have on costs?

William Matthew Walsh
CEO & Executive Director

Thanks, Andrew. Maybe I'll let Alex comment on the Monarch. But we don't have an intention at this stage or requirement to use any of the Qatar aircraft. So what we set out to do is to cover as many as we could with our existing resources from within the group, including BA from Heathrow into Gatwick [that] [sort of help from] Aer Lingus [Vueling] so -- and then whatever residual [indiscernible] Alex, do you want to...

Alejandro Cruz de Llano
Chairman & CEO

There will be a limit -- limited amount of leasing this year. We are covering some of the lines with our own aircraft, and we will evolve from there. But no Qatar aircraft.

William Matthew Walsh
CEO & Executive Director

So it's been better than some of our competitors who have acquired spots elsewhere where they've been [in effect] almost completely with leasing. This is, again, the advantage of the group that we're able to pull together resources from across the group to cover as many of the operations as possible. So you're

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going to see Aer Lingus operating at Heathrow, some flights to the BA, which freed up some BA assets to go into Gatwick. So we'll continue to try and do as much as we can from within our own resources and only then look for [indiscernible]. In terms of LEVEL, LEVEL does best within the JBA. So as you know, OpenSkies was in the JBA or is in the JBA, and LEVEL will replace capacity that was provided by OpenSkies. So American welcomes the development. This is seen as a response [that] I think American recognizes needs to be made. I've been very pleased actually. I think the relationship with American is very positive and gets stronger day by day. Our thinking is becoming almost completely aligned. Our challenges are probably the same as theirs, our opportunities are probably the same and we're working with them to see if there's anything more that we can do. But LEVEL will operate within the JBA. And Paris operation will replace capacity that was in the JBA already being provided by OpenSkies. And in Italy, as I said before, we did give a good look at Alitalia to see was there anything that might be of interest. I don't know, Javier, if you want to comment? We were approached by other airlines who were interested in acquiring Alitalia, but didn't want to acquire it all. And were looking for somebody to take bits and pieces of. So we had some dialogue to see if there's opportunity there.

Javier Sanchez-Prieto
Vueling Chairman & CEO

Yes, as Willie has said, I mean, there's a lot of things going on there in the Italian market. The good thing about that is that we are willing -- as a group, I think that we are well-positioned to take advantage of some of the development. We have seen that already in our figures in 2017. So we've seen that it [needs] development. And of course, we have done some good developments also in Vueling. But I think -- I believe that the market is being restructured, and we are taking advantage of that and we will continue doing so in an inorganic way in 2018 and we're always open to these opportunities. But if that opportunity is not happening, we're always prepared to take advantage in organic.

Damian Brewer
RBC Capital Markets, LLC, Research Division

Damian Brewer, RBC. Three questions, please. First, we're just coming down to the BA defined benefit pension changes and as that goes through you've hinted already that's could slow down the progress a little bit of the cost efficiency for the second half of the year. Does that, therefore, mean that when we're looking at costs from the BA side of IAG for this year, most of that efficiency, if you like, momentum, would likely come from the second quarter onwards [what's the thinking]. If you could expand, give some more details on that, that would be great. Secondly, just looking at sort of, if you like, the incremental profits for ASK, all 4 operating companies delivered quite impressive incremental operating profit for ASK. But I was just wondering, Iberia, in particular, it was up nearly 35%, 40%, whereas Aer Lingus was up only about 3% to 4%. So I just want to understand why Iberia next year gets lower growth rates in terms of incremental capacity compared to Aer Lingus? Do you expect that position to reverse for what's going on there? And then very finally, and since IAG was formed, you've been running at very high level of one-off charges against very exceptional profit. How much of that was cash in terms of 2017? What would you expect the run rate to be going forward? And if that comes down, particularly the cash element, does that open up more potential things like share buybacks, dividends or inorganic growth?

William Matthew Walsh
CEO & Executive Director

Okay, [John] deal with the first issue?

Unknown Executive

Just to give you a little bit more flavor. I think your assertion, Damian, is right. That it's going to be from Q2 onwards rather than Q1. Just to give you a bit more flavor on pensions, we basically reached an agreement with the unions pre-consultative ballots in mid-December. And then in early January, the pilots [an offer then] for them, put out by consultative ballot, and that then ran to the end of January. Then at the end of January Unite commenced their consultative ballot, which finished last week -- it was on the 19th, so this week, on Monday. So having now got through the -- we got through the [GMB] [ballot] for Unite, the only final hurdle left to do is to get through the trustees, and the trustees have to

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go through due process as we talked about earlier, and that will happen in March. So because we were going through that consultative ballot, we thought it was very important to keep the focus on the pension change rather than other changes that we would like to make. And hence, your assertion with regards to is it Q2 onwards, I think that's a fair assumption.

William Matthew Walsh
CEO & Executive Director

So about the cash?

Unknown Executive

Yes, yes, so as you were mentioning a significant part of those below the line movement and differences with [FY] 2016 are noncash elements. So evaluation, mark-to-market of noneffective hedges is a noncash element. Financial charges on pension funds is in general terms a noncash element. The benefit and the losses on disposals of assets, it is cash, okay? But at the end of the day, we need to go to the end of the cash flow statement and the end of the cash flow statement this year has been able to make for us EUR 2.7 billion. Next year, probably the figure is going to be lower than that because we are going to have more fleet deliveries. But having said so, again, the big message is both the regular payments and eventually another, I would say, share buyback program would be well covered, more than 2x by our net [indiscernible]

William Matthew Walsh
CEO & Executive Director

In terms of the investment, yes, the Iberia performance in 2017 was very good. Clearly, they benefited [from macro-economic performance]. We're not in any way penalized. We do look longer term at investments. Aer Lingus has been able to grow 12% retaining a 23% ROIC, and we challenged them. Is that sustainable? We don't want just performance in 1 year. Is it sustainable? And you do that, can you continue to grow? Can you continue to add aircraft? Can you continue to deliver this performance? And looking at Stephen, I know his answer because he demonstrated to us that he can and will. The same with Iberia. So Iberia will take delivery of new aircraft this year, the A350 comes into Iberia [this aircraft in] June. Yes, maybe [if you'd like to] comment, Luis? So this year, introducing a new aircraft type, particularly new long-haul aircraft type is something that you need to take time and be careful about. And so Stephen, talk about your [indiscernible]?

Luis Gallego Martín
Chairman & CEO of Iberia

We will receive our first A350 and also we are going to receive our 2 first A320neo. The challenge that we have is with the growth that we have presented. We need to grow it -- improve our ROIC margin and that's the challenge that we have. In one way we need to handle the impact in the RASK that we are sure we are going to have with this growth. That with the measures that we have in the Plan de Futuro, we are going to improve the margin also from the cost side. So that's the challenge that we have for this year. The new generation aircraft and all the things we are doing in the company, we are sure they are going to achieve the results that we're expecting.

Daniel Röska

It's Daniel from Bernstein Research. Three, if I may. Maybe first one, comment a little bit on your Brexit situation and we all can kind of think through what that may entail for your corporate structure? Do you see a path forward in the medium term that would actually lead you to revisit the bylaws on the IAG holdings or leading you to kind of a situation where the IAG stock comes with stock without ownership restrictions? And second one, Avios has been a little bit absent in the communication for the past couple of months. Just wondering if you could comment on the realignment and how Avios plays in kind of to the IAG platform strategy, but also distribution strategy going forward. And lastly, maybe on the tandem between LEVEL and Vueling, kind of how important is Vueling to what you're planning with LEVEL, and any thoughts going forward kind of some thoughts [to it]?

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William Matthew Walsh
CEO & Executive Director

We don't see any change to the structure [We, the structure works today but] going forward, and clearly, if we needed to or wanted to adapt, we'd look at that, but we don't envisage any. In relation to Avios, very good performance, actually it was a record performance for them as well. So I probably should highlight that. What they're doing and what you'll see in Capital Markets, we're doing sort of a refresh of Avios, which will go to our board in March. And expect that to be approved by the board in March and then we'll talk more about it after that. We felt it was probably more appropriate to talk about it after we've completed that. So with Bill Crawley having gone in there as the CEO he's completed his review. We've -- we were originally going to take that to the board yesterday, but we had too much on our agenda. So it's postponed. I fully expect that to be approved by the board. And then we will talk more about what we plan to do. And interestingly, LEVEL and Vueling, with the 330 with wide-body long-haul low-cost, we believed and we still do that [speed] is important. It hasn't been as important with the start up as we thought. And in fact, it's been a surprise both to [us centrally] but also to Vueling. They are seating some passengers into [indiscernible] at the level. But it's not needed either. The point-to-point demand has been much stronger. So I think it just reinforces our view that where we're targeting or we believe are underserved cities in continental Europe from a long haul point of view that you can get into these cities and you can generate new demand, stimulate new demand with the pricing structure that we have. And there's the inherent underlying demand that just wasn't being served. But ultimately, we do believe that the short haul takes a lot of work in the long-term, but we haven't needed it with the 2 aircraft. And actually, we don't see a need for it to support the 3 aircraft that we have acquired. But going forward, as we exploit the opportunities that we see in Europe, we do see the -- and certainly, that's what we see with others who are trying to do. But so far, it's not been a [indiscernible].

Alex Paterson
Investec Bank plc, Research Division

It's Alex Paterson from Investec. Just following up on that, the LEVEL. Clearly, you've been able to get this airline flying very quickly. It hasn't cannibalized [those you feed] into it. On your, I think, Slide 20 [you show you go] 3 aircraft -- sorry 2, 5 and then just like [10] involved and so on, what would encourage you to increase the 10 that are involved? Is it that the constraint is that you want to learn with [it as it is] a [different edition] of aircraft or what is it that stops you being 25 aircraft in 2022?

William Matthew Walsh
CEO & Executive Director

That's interesting because that's exactly the challenge I get from some of our board members when we present the feedback that we've seen from it so far. There's a couple of issues. We're not worried about the model because we were confident the model worked before we launched. I think we watched very carefully and researched it for some time. We're more confident given our experience of operating [so far, yes] 2 aircraft for a very short period of time. But certainly, the trends that we expected to see, we've seen them and [indiscernible] and we're very confident that the launch in Paris, as again, we know that market. We have a strong presence on the ground there and we know how we can exploit the market there. Going forward, we're looking at what is the right aircraft. So there is an aircraft decision that we need to make. We're very clear that we could get into the market very efficiently with the 330-200 and the configuration that we are talking about. And the unit cost performance has been better than we have expected. And we did highlight that the cost advantage of a 787 is significant, but with fuel prices where they were, that $500 a ton or even at $650 a ton, that isn't enough to offset the ownership cost. When you cross a couple of lines: One, there are more and more 787s in the market, there are more and more 787 qualified pilots in the market, there's more experience and support for 787. So as that aircraft matures and as ownership costs decline and as fuel prices maybe change, but, so we're looking at an aircraft decision as much as anything else. We still see opportunity with the Airbus aircraft and we see opportunity with the Boeing aircraft. And we want to make sure -- so the chart you saw shows, I think, shaded aircraft, which shows the opportunity. And all the time we're looking at flexibility, all the time we're looking at flexibility across the group within the individual airlines, but across the group. If we needed to adjust capacity downwards, what flexibility do we have? But the confidence in the model is stronger

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today than it was before we launched, and we will see opportunities from an aircraft point of view. And I think the 787 more and more we see as an opportunity in the future development level. Very pleased as I say with the 330, very pleased with the cost performance. So at 5 years' time, is the 330-200 the right aircraft.

Unknown Executive

As Willie is saying, in some ways, 787 is a fuel cost hedge for the group, 330 is an ownership cost hedge for the group. So we could be foreseeing a combination of [them]

Penelope Jane Butcher
Morgan Stanley, Research Division

Penny Butcher from Morgan Stanley. Just one from my side, in a similar vein to Daniel's question about leaving out talking about Avios. On the sort of broader international partnership, you obviously have reiterated your commitment to American. Could you update us on the latest with LATAM and [particularly] the Asia side of the market given there's pretty explosive growth out of the Chinese carriers into expanding their international businesses? What are your kind of options and opportunities there?

William Matthew Walsh
CEO & Executive Director

With the LATAM, as you know, we're pursuing a joint venture that requires regulatory approval. We're still awaiting clearance in Chile. We have it in -- yes, it's Chile. So subject to that, we will develop the joint business with LATAM. In China, we've entered into a closer relationship with China [indiscernible] with British Airways on codeshare. We continue to look for opportunities there. We're seeing a lot more interest in working with us from the Chinese carriers. As you know, we don't have a Chinese carrier in oneworld, which has been an issue for us. And we've been overly concerned about that because we've been able to serve China both directly and with our oneworld partner, Cathay Dragon over Hong Kong. But I'm pleased with the relationship that we're developing with them [indiscernible] [expand the southern route, in particular] in fact it's been very encouraging, Alex -- sorry, Alex is going. So maybe I'd announced something that Alex was going to announce. So we'll continue to look for bilateral relations to develop them principally with British Airways, but also with Iberia, something [we've seen more] for interest in that. So I see it as an opportunity. I'm not concerned that we haven't had a stronger position there in the past. I do see this as an opportunity.

Penelope Jane Butcher
Morgan Stanley, Research Division

For India?

William Matthew Walsh
CEO & Executive Director

No, maybe I'd say that's too quick. We'll probably look at that, but I think I've always dismissed the idea of Air India while government ownership is involved. Now, what the government is saying now is a million miles away and better than has been said in the past. But I don't think it would be enough to encourage us to go for this. That's a company that requires massive restructuring. There appears to be an appetite for us, but I'd want to see some evidence of the restructuring. So I think it would be a risk that wouldn't be justified at this stage. So I think the answer is no. We haven't been looking at it for -- we're aware of what's going on, but it's not something that's [indiscernible]

Unknown Analyst

Can I just come back to your guidance, especially the unit revenue guidance? I'm just curious to understand how your thought process is guiding for increasing unit revenues for the full year at this point of the year while H2 visibility, obviously, is still very low. So is it that H1 is so strong that you are comfortable giving that guidance? Or is it more a function of extrapolating the current demand trends and capacity trends into H2?

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William Matthew Walsh
CEO & Executive Director

No, what we did was -- we have a budgetary process, we have a business plan process, we have a financial plan process. Our financial plan hasn't been approved by the board, which was -- I have to be honest, based at a lower fuel price. We didn't saw a momentum in the fuel price since we came through the fourth quarter. We went back through all of the operating companies to say what do you see in an environment where fuel prices are in the 650 dollar range as opposed to maybe the 550 dollar range. And we're very encouraged by what we saw in 2017, the visibility that we have. So clearly, Q1 is probably easier for us to call, particularly as Enrique said with Easter at the end of March, you'll get a benefit of Easter in Q1. But looking at everything that we see at this stage, and we're not by any means being aggressive. We see a path, the unit revenue improvement through the year [particularly] unit revenue performance in 2018 [indiscernible]. It would be easy for us to give you a confident statement about Q1. [You'd be amazed that] anybody doesn't do that because given what we're seeing already and the Easter [effect for one]. But based on what we're seeing, our assessment of capacity, our assessment of demand and we're...

Unknown Executive

And the reaction that we've been in some way achieving through our teams and the market response in Q1 is [very encouraging].

Unknown Analyst

[indiscernible]

William Matthew Walsh
CEO & Executive Director

We are growing ahead of the markets. But that's principally through what we're doing with LEVEL, what we're doing with Aer Lingus, some of the recovery in Iberia, what Vueling is doing. So we're slightly above what -- growing slightly above and growing unit revenue. Absolutely, it's the right thing to do with flexibility that we have to adjust capacity. So I always say when we give headline capacity growth figures of 6.7%, I'd be surprised if it is less than that because we always tweak it on a tactical basis. But equally, in 2017, we went above the guidance that we've given and that was on the back of LEVEL and on the back of some opportunity that the airlines saw at certain times. But the capacity that we're seeing across all of the core markets that we have is encouraging. We are seeing some interesting growth in the long haul low cost in certain markets. But we're actively involved in that so we can understand what is happening there. And we're particularly encouraged by what it is we're seeing so we can perfectly understand what's happening there. I don't expect all of that capacity to materialize given the performance of some of the airlines that we're talking about. So as we look at the -- but if I look back at 2017, demand exceeded capacity in all markets in 2017, all geographic locations, in all markets. Now we always know you can do that by heavily discounting prices. But in an environment where unit revenue was good, we expect the demand to match the capacity. It may not exceed the capacity in 2018, but we certainly expect it to match and in some markets, we expect it to exceed. So we still see a pretty healthy capacity demand environment as we look at 2018 from our position.

Unknown Executive

So thank you, everyone, for your questions at this time. Thanks, Enrique and Willie, and management committee for the answers [indiscernible] and we'll speak to you again on the first quarter call.

William Matthew Walsh
CEO & Executive Director
Thank you.

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