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Presentation

OPERATOR: Good morning and welcome to United Continental Holdings earnings conference call for the third quarter 2014. My name is Brandon and I will be your conference facilitator for today.

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(Operator Instructions)

This call is being recorded and is copyrighted. Please note that no portion of the call may be recorded, transcribed, or rebroadcast without the **Company's** permission. Your participation implies your consent to our recording of this call. If you do not agree with these terms, simply drop off the line. I will now turn the meeting over to your hosts for today's call, Nene Foxhall and Jonathan Ireland. Please go ahead.

NENE FOXHALL, EVP OF COMMUNICATIONS & GOVERNMENT AFFAIRS, UNITED CONTINENTAL HOLDINGS, INC.: Thank you, Brandon. Good morning, everyone, and welcome to United's third-quarter 2014 earnings conference call. Joining us here in Chicago are Chairman, President, and CEO, Jeff Smisek; Vice Chairman and Chief Revenue Officer, Jim Compton; Executive Vice President and Chief **Operations** Officer, Greg Hart; and Executive Vice President and Chief Financial Officer, John Rainey.

Jeff will begin with some overview comments, after which Jim will discuss revenue and capacity. Greg will follow with an update on our **operations**. John will then review our costs, fleet, and capital structure, after which we will open the call for questions, first from analysts and then from the media.

(Caller Instructions)

With that, I'll turn the call over to Jonathan Ireland.

JONATHAN IRELAND, MANAGING DIRECTOR OF IR, UNITED CONTINENTAL HOLDINGS, INC.: Thanks, Nene. This morning, we issued our earnings release and separate investor update. Both are available on our website at ir.united.com. Information in this morning's release and investor update and remarks made during this conference call may contain forward-looking statements, which represent the **Company's** current expectations or beliefs concerning future events and financial performance.

All forward-looking statements are based upon information currently available to the **Company**. A number of factors could cause actual results to differ materially from our current expectations. Please refer to our press release, Form 10-Q, and other reports filed with the SEC by United Continental Holdings and United Airlines for a more thorough description of these factors.

Also, during the course of our call, we will discuss several non-GAAP financial measures. For a reconciliation of these non-GAAP measure to GAAP measures, please refer to the tables at the end of our earnings release and investor update, copies of which are available on our website. Unless otherwise noted, special charges are excluded, as we walk you through our numbers for the quarter. These items are detailed in our earnings release. And now, I'd like to turn the call over to Jeff Smisek, Chairman, President, and CEO of United.

JEFF SMISEK, CHAIRMAN, PRESIDENT & CEO, UNITED CONTINENTAL HOLDINGS, INC.: Thanks, Nene and Jonathan, and thank you all for joining us on our third-quarter 2014 earnings call. Today, we reported pre-tax earnings of \$1.1 **billion**, the highest quarterly profit in United's history. We earned \$2.75 per diluted share, nearly double our earnings per share in the third quarter last year. We had good revenue and cost performance in the quarter.

Our revenue results demonstrate the progress we're making in our revenue management, network, and Express operation, while our solid cost performance largely reflects the early results of Project Quality, designed to deliver \$2 **billion** of annual cost savings by 2017. During the quarter, we also returned \$220 **million** in cash to our shareholders under our \$1 **billion** share buyback program.

I want to thank our employees for their hard work during the summer and for their skills in responding to the multi-week outage of the Aurora [en] route FAA facility, which significantly affected our **operations**. They did a great job responding and handling the effects on our customers and I am proud of them.

So far this year, we've made a number of improvements to our **operations** and will continue to focus on our reliability and product. Our goal is to deliver flyer-friendly service, a competitive product, and competitive margins. We're continuing to take steps to improve the customer experience for our passengers, including installing in-flight satellite-based WiFi and streaming video on our mainline fleet, as well as adding WiFi and streaming video on our two-cabin regional fleet.

As of today, we have WiFi on more than one-half our mainline aircraft, nearly 200 of which are equipped with streaming video. By the end of the year, two-thirds of the mainline fleet will have WiFi and we will have begun installation on our two-cabin regional fleet.

Our progress this quarter shows that our plan is working. We're excited about the opportunities ahead and this Management team is committed to executing in each area of the business to realize this **Company's** potential. We will continue to make progress against our plan and will take all appropriate actions to generate the level of earnings we and our shareholders expect. Now, I'll turn the call over to Jim, Greg, and John.

JIM COMPTON, VICE CHAIRMAN & CHIEF REVENUE OFFICER, UNITED CONTINENTAL HOLDINGS, INC.: Thanks, Jeff. First, I'd also like to recognize our employees for running an ever-improving airline this quarter. I appreciate our employees' commitment to providing great service to our customers. I'd also like to thank our customers for choosing United. We are making strides each day to improve your flying experience and we appreciate your business.

In the third quarter, United's consolidated PRASM grew 3.9% on capacity growth of 0.5% year-over-year. The improvements we've made to our Pacific network continue to pay off. Our new routes to Chengdu and Taipei have both performed better than expectations. We also continued to see strong results from transforming our Narita flying and regauging our Australia routes. Additionally, high demand for our **China** service during the peak summer travel season helped offset pressure from the continued industry capacity growth.

Our trans-Atlantic flying was also able to absorb the additional competitive capacity and performed better than expected in the third quarter, largely driven by strong premium cabin bookings, particularly in London. Although the trans-Atlantic entity has experienced several recent pressures, including Middle East unrest, Ukrainian conflict, and more recently, concern about Ebola, we have not seen any meaningful impact on bookings to date. In the Latin American markets, particularly deep South America, we exceeded our expectations, recovering more quickly from the World Cup slowdown than we initially anticipated.

In the third quarter, revenue from our total Corporate portfolio, including our rapidly growing PerksPlus product, grew approximately 5%. Ancillary revenue continued to grow in the third quarter, increasing approximately 11% per passenger and keeping us on track to achieve \$3 **billion** in ancillary revenue in 2014.

During the quarter, Economy Plus revenue increased by double-digits due to enhanced pricing optimization and a lower refund rate. We decreased the refund rate by implementing an improved solution for reseating customers during aircraft swaps. Additionally, we recently began to sell Economy Plus through the Amadeus and Sabre distribution systems, allowing our travel management partners and travel agencies to seamlessly book extra legroom seats for our customers, further driving additional Economy Plus sales.

We are pleased with the progress we're making on improving our revenue thus far and we still have many more opportunities to optimize the value of our network. On the last earnings call, I introduced our three-pronged approach to growing passenger revenue, enhancing our revenue management practices, optimizing our network and schedule, and improving our United Express **operations**. I'd like to provide you with an update on each of these areas.

First, in revenue management, our booking curve optimization initiative increased third-quarter PRASM by 1 point. Additionally, our recently restructured Premium cabin fares on many of our domestic and short-haul Latin flights added a 0.5 point of PRASM in the third quarter and increased the Premium paid load factor on these routes by 12 points year-over-year to 40%.

Second, our recent changes to the network and schedule are improving the bottom line as well. In the second quarter, for example, we significantly reduced flying from Cleveland and realized the full effects of this change to the network in the third quarter. We expect the run rate annual benefit of this change to be approximately \$60 million.

We are making progress on other network and schedule initiatives, including our redesign of the flight [bank] structure at our hubs in Chicago, Denver, and Houston. We implemented the newly rebanked schedule in Denver at the end of September and will follow with Houston late this year and Chicago in March of 2015. This phased rebanking will allow for optimal peaking across the network during the high-demand summer period next year.

Additionally, we continue to increase the seasonality of our flying. We view seasonal shaping as an additional step in our commitment to capacity discipline. By adding more flying to the peak summer travel period and reducing flying during the lower demand shoulder periods, we expect to improve our yield over the full year.

This will be most notable in the trans-Atlantic markets. For example, in July 2015, we will fly over 40% more trans-Atlantic capacity compared to February 2015, while we expect our full-year trans-Atlantic capacity in 2015 to continue to reflect appropriate capacity discipline. We expect this seasonal scoping of capacity to generate almost a 0.5 point of PRASM improvement in our trans-Atlantic entity for the full year of 2015.

This quarter, we launched a new initiative to consolidate departure frequencies throughout the network. Frequency consolidation will reduce cost, improve reliability, improve the product offering, and provide more Premium seating. As an example, in January, with our Denver to Minneapolis route, we are reducing service from five flights per day, comprised of a mix of Express and mainline aircraft, to four flights per day, comprised exclusively of mainline flying on weekdays. In this example, we are only increasing our daily seats by 3%, while increasing seats per departure by approximately 30%.

We've already implemented similar changes in other routes in Chicago and Newark. The effect of these changes will be seen throughout the network, as we plan on increasing gauge by 5% in 2015, while reducing departures by 3%. The effect will be most pronounced in Chicago, which will see average daily departures drop approximately up to 8% and seats per departure increase up to 10% in some months. This not only drives efficiency-related margin improvement, but also helps to better manage the congested air space around O'Hare.

Third, we continue to make good progress on improving our United Express operation. This quarter, we announced that we will add 50 incremental two-cabin E175s to our fleet and we will remove 31 Q400 propeller aircraft beginning in 2015. Including these regional fleet changes, we expect to have 85 E175s in our fleet by the end of next year.

Our continued progression to more modern, consistent, fuel-efficient, and larger gauge regional aircraft will improve the operational and revenue performance of our Express operation, while substantially improving our product offering. For each 50-seat aircraft an E175 is replacing, we expect to generate over \$1 million of annual improved profitability. In summary, we are pleased with the initial progress of our three-pronged revenue initiative, but we recognize that it will take some time before we realize the full benefits.

Before turning to fourth-quarter revenue guidance, I would first like to remind you of a 1.5 point PRASM tailwind we received in the fourth quarter of 2013. As we explained in our fourth-quarter 2013 traffic releases, this tailwind was due to certain interlying ticket reconciliations. As this was one time in nature, we will be facing a 1.5 point PRASM headwind in the fourth quarter of this year. Taking this into account, we expect our [unit] revenue to be essentially flat in the fourth quarter of 2014 compared to the fourth quarter of 2013.

The domestic entity continues to display strong demand in the fourth quarter. Continued capacity discipline has supported the consistent unit revenue growth in the last several quarters and we expect domestic strength to continue into the fourth quarter. The Atlantic region is demonstrating improved capacity discipline in the winter period. In the Atlantic, we expect that the United joint venture with Lufthansa and Air Canada will reduce trans-Atlantic capacity by approximately a 0.5% this winter, with United down 3%.

As previously mentioned, our Pacific strategy is yielding solid results; however, we continue to see roughly 20% competitive capacity growth between the US from both Shanghai and Beijing, which is putting pressure on our unit revenue performance, as peak summer demand tapers off. Additionally, the weakening yen is applying renewed pressure on our Narita flying.

We expect the combination of these two factors, as well as increasing stage lengths due to our newly launched margin-accretive Pacific routes, to provide approximately 1.5% headwind to our consolidated PRASM performance for the fourth quarter. In spite of these challenges, the Pacific remains a solidly

profitable entity for United and continues to be one of the fastest growing regions in the world. United is the best-positioned US carrier to capitalize on this growth in the future.

In the Latin markets, we will grow our capacity in the fourth quarter along with many of our peers. We expect to grow our seasonal capacity by double-digits in the high-demand fourth quarter, driven primarily by capacity expansion in the beach markets. This fourth-quarter seasonal growth allows us to more opportunistically and efficiently redeploy marginal capacity from elsewhere in the network on a seasonal and day-of-week basis. However, as is often the case with significant capacity additions, we expect to face PRASM pressure in the Latin entity in the fourth quarter, but believe these additions will be profit maximizing for the overall network.

Turning to our consolidated capacity, we expect our consolidated capacity in the fourth quarter to grow 0.5% to 1.5% year-over-year. As we look toward 2015, we expect to grow consolidated capacity by 1.5% to 2.5% for the full year, with 0.5% to 1.5% growth in our domestic entity. This growth will be very efficient.

Approximately one-half of this growth will come from the installation of slimline seats and upgauging of aircraft. The remaining growth will come largely from increasing the utilization of our fleet, as our improving operation permits us to reduce fares and the completion of aircraft modification programs allows us to return aircraft to regular service.

As United, we remain committed to growing capacity below GDP, as we believe this strategy will generate the best opportunity for margin expansion. In conclusion, I am pleased with our continued improvement in revenue management, network planning, and our Express operation, and I'm excited about the many significant opportunities we have ahead of us. With that, I'll turn the call over to Greg.

GREG HART, EVP & COO, UNITED CONTINENTAL HOLDINGS, INC.: Thanks, Jim. I would also like to take this opportunity to thank our employees for their tremendous efforts in the third quarter. This quarter presented many unexpected operational challenges, like the fire at the FAA's facility in Aurora and we appreciate their hard work and dedication to transforming United into a more efficient, flyer-friendly airline. At United, we are reinventing the airline from an operational standpoint and are focused on becoming better and more efficient in everything we do.

Over the last year, we have transformed our approach to the business. We don't take past practices as a given. Instead, we challenge ourselves to find new and better ways for everything we do, each and every day. When we talk about reinventing the business from an **operations** perspective, we think of it in three broad categories: reducing variability, leveraging technology to improve our handling of irregular **operations**, and streamlining and simplifying our **operations**.

We have many initiatives underway to reduce the variability in our **operations**. One example is more effectively positioning spare parts into the appropriate stations where they are needed. Through this effort, we've reduced spare parts-related cancellations in the third quarter by more than 20% year-over-year. This improvement in reliability allows us to reduce the number of spare aircraft, which in turn improves fleet utilization and revenue.

We are also taking steps to improve our reaction to and recovery from irregular operation, which are largely driven by weather and air traffic control delays. Our goal is to more effectively run the operation during irregular events and then rebuild our airline as soon as the event passes. To improve the operation during such events, we are deploying technology solutions to more strategically cancel flights and more opportunistically route passengers around impacted regions.

We are also developing new mobile tools for our airport agents to more quickly assist passengers during irregular **operations**. For example, these tools will allow roaming agents to scan boarding passes in order to quickly assist passengers in determining optimal rerouting opportunities.

We also have significant opportunities to streamline and simplify our **operations**. There are numerous initiatives underway focused on driving efficiencies through simplification. As mentioned on the previous earnings call, we are reducing the number of Express carriers operating in each hub. At the same time, we are reducing Express fleet combination in several airports. As an example, in Washington Dulles, we are going from eight Express aircraft types down to five. These simplification efforts allow us to reduce the number of Express maintenance bases by nearly 25% through base consolidation.

While we are proud of the improvements we are making in the operation, we are excited about the many opportunities we have to make us a more reliable and efficient airline. With our assets, dedicated employees, and ability to execute, we expect to continue to improve our operation over the coming quarters. With that, I'll turn the call over to [Jeff].

JOHN RAINEY, EVP & CFO, UNITED CONTINENTAL HOLDINGS, INC.: Thanks, Greg. And thanks to everyone for joining the call this morning. Up want to reiterate my appreciation to the United team for their

hard work throughout this quarter. Throughout the **Company**, our employees are making meaningful improvements to United and I appreciate their efforts.

Today, we reported \$1.1 **billion** of pre-tax income for the third quarter. Our third-quarter earnings per diluted share were \$2.75, nearly double our earnings per share in the third quarter of last year. Our return on invested capital over the trailing 12-month period reached 12.3%, the highest result in the last three years. Our operating margin was 11.7% and our pre-tax margin was 10.2%, both more than 450 basis points higher than last year.

We're pleased with the continued financial improvement we've made and we're excited about our opportunity to significantly grow earnings. We are all working hard to increase our revenue and improve our efficiency to generate the level of earnings we and our shareholders expect. Our third-quarter consolidated CASM, excluding fuel, third-party business expense, and profit sharing, increased 1% year-over-year.

We are continuing to make good progress on our Project Quality initiative. This year, we expect to achieve nearly \$200 **million** of fuel savings, and now expect over \$300 **million** of non-fuel savings. Our full-year estimate for both of these numbers has increased with each quarter this year as we continue to perform better than our original expectation.

A key component of the non-fuel savings is productivity and we continue to make great progress in this area. This quarter, we improved productivity by 4%, marking the fifth consecutive quarter in which our productivity has increased, keeping us on track to achieve our 2014 goal of a 3% improvement. We expect fourth-quarter non-fuel CASM to increase between 1.25% and 2.25%, resulting in a full-year CASM estimate in line with our original guidance, despite a 1 point reduction in our capacity projection that we provided at the beginning of the year.

In the third quarter, we returned \$220 **million** to shareholders through a combination of an accelerated share repurchase program and open market transactions. We are pleased with the early progress we have made in our \$1 **billion** share buyback program and we will continue to opportunistically repurchase shares over the coming quarters.

We're making good progress in improving our balance sheet. In the third quarter, we redeemed the entire \$800 **million** of our 6.75% secured notes. At the same time, we closed on a transaction under our existing \$1.9 **billion** credit facility, in which we increased the size of our undrawn revolver by \$350 **million** to a total of \$1.35 **billion**, and also issued an additional \$500 **million** tranche of term loan debt.

We've also made meaningful progress in reducing our convertible debt. Earlier this month, we retired all \$248 **million** of our 6% convertible preferred securities due in 2030. We also issued a redemption notice for the remaining \$56 **million** of our 6% convertible debt due in 2029. Furthermore, in January 2015, the \$202 **million** outstanding of our 4.5% convertible notes will mature.

Following that maturity, we will no longer have any outstanding convertible debt. This represents a \$1.9 **billion** reduction in convertible debt since the merger. These transactions are representative of our stated long-term goal to reduce gross debt to \$15 **billion** while maintaining an appropriate level of liquidity.

Our capital expenditures in the fourth quarter were \$493 **million**, and in the fourth quarter, we expect to spend approximately \$1 **billion**. We plan to take delivery of five 737-900ERs, one 787-8, one 787-9, and 11 E175s in the quarter. Apart from the additional E175s that Jim already mentioned, earlier in the quarter, we announced an agreement with Boeing to convert seven 787-8s, delivering between 2017 and 2018, into larger, more efficient 787-10s, that will be delivered in 2022 and beyond.

In addition, we recently decided to retain 11 767-300ER aircraft that we had originally planned to retire and will invest in these aircraft with new interiors, winglets, and reliability modifications to extend the useful life of these aircraft into the next decade. In addition, we continue to explore the used aircraft market to find suitable aircraft that will allow us to reduce CapEx and right-size our fleet without substantially increasing fleet complexity. For example, we recently reached an agreement to **purchase** two used 737-700s to backfill flying as 50 seaters exit the fleet. These changes to the fleet plan demonstrate our discipline in managing our capital allocation.

I'm encouraged by our third-quarter performance and the progress we're making to expand revenue, reduce cost, improve the balance sheet, and return cash to shareholders. Through these actions, we are expanding earnings and demonstrating our commitment to increasing shareholder value. I'll now turn it over to Jonathan to open up the call for questions.

JONATHAN IRELAND: Thank you, John. First, we will take questions from the analyst community. Then we will take questions from the media.

(Caller Instructions)

Operator, please describe the procedure to ask a question.

Questions and Answers

OPERATOR: (Operator Instructions)

From Cowen and **Company**, we have Helane Becker on the phone. Please go ahead.

HELANE BECKER, ANALYST, COWEN AND **COMPANY**: GDP forecasts keep changing on an almost daily basis. Can you just talk about the leverage you have to adjust capacity, either if GDP slows from current forecasts for next year or accelerates?

JIM COMPTON: Hey, Helane, this is Jim. We have a history of creating a flexible fleet plan and that is -- clearly, as we head into 2015, we have the ability to adjust our capacity to economic changes. We gauge GDP forecast based on consensus out there, so you're right, it does move around. But we do have the ability with utilization of the aircraft, working really closely with our tech house team to more finely tune when we can do work on our airplanes to also.

The history of the flexible fleet plans continues for us and we have great flexibility to adjust to the economic environment. And we will -- it is about keeping demand and capacity in line and that's what we're really focused on.

HELANE BECKER: Okay. And then just as a follow-up question to that capacity comment you made about Chicago going to more seats per departure and fewer departures per day, are you worried that competitors will come in and backfill what you're doing with additional capacity?

JIM COMPTON: Helane, it's obviously a very competitive business that we're in and so that schedule that we'll be building in Chicago will be a very attractive schedule to the business passenger, as well as the leisure passenger. We're confident with the seat growth that we apply by upgauging, that we'll be very competitive in the market.

HELANE BECKER: Great. Thanks very much.

OPERATOR: From JPMorgan, we have Jamie Baker on the line. Please go ahead.

JAMIE BAKER, ANALYST, JPMORGAN: Hey, good morning, everybody. I want to commend you on showing significant relative margin improvement in the third quarter. You basically halved the operating margin deficit relative to Delta, but it looks like you're guiding for a bit of slippage in the fourth quarter. You have explained why. That's fine. If we set aside the first quarter of next year, where we at least hope that you're going to have ridiculously easy weather comps, in what quarter next year do you expect the initiatives that you've been talking about here to be showing the most relative momentum to the industry?

And furthermore, do you have an internal target as to where you'd want your relative margins to be by the end of next year? And I'm not trying to pry guidance out of you. I'm just curious as to whether you believe you can achieve margin parity with other best-in-class operators. If you think you can, when?

JOHN RAINEY: Jamie, this is John. I'll tell you, I can't predict necessarily what other carriers are going to do. I'm going to tell you that we're focused on United Airlines and what we can do to create value for our shareholders. We recognize we have some further improving to do. This was a record profit for us this quarter. Our guidance in the fourth quarter would **lead** you to what is also a record profit for United in the fourth quarter.

We've talked about our desire to make money in the first quarter and we want to continue to expand earnings. We are only about 25% of the way through our Project Quality initiative. We're in the very early stages of our revenue initiative. And so we think that we've got a lot of improvement, a lot of opportunity in front of us.

We would all like to close that margin gap as soon as possible. I promise you that the team here is extremely focused on it. We don't like our relative place in the industry, that's a fact, and we think that we've got a lot of opportunity to improve.

JAMIE BAKER: Excellent. And a follow-up for Jim Compton. Ultimately, Jim, what solves the **China** problem? And I only ask because, again, bringing up Delta, they have a decent solution for Tokyo longer term. It's called Seattle. But in your case it's tough for me to see what you can actually do about **China**, until such time that your competitors there suddenly wake up and choose to focus on returns. Is there a better **Chinese** strategy other than simply hope?

JIM COMPTON: Hey, Jamie, we're -- obviously, **China** is a big part of our network and a very profitable part of our network. It's a very strong, growing part of the world from a demand perspective. We continue to

expect that. So our footprint there, we think, is the best position. I'll tell you our strategy is well beyond hope.

If you think about the things that we're doing with the flexibility of our fleets, the 787, San Francisco to Chengdu is a perfect example of that, that we're tapping into that growth in **China** in ways that, quite frankly, our competitors can't, as we continue to match capacity and demand. So we call it our second phase of our Pacific; that's combined with what we're doing in Tokyo with our JV partner to put the flying out of Narita, work with them, much [color posed here] on the connections. But as it is to **China**, we're well positioned and we feel we have lots of opportunity to do well as that market continues to grow.

JAMIE BAKER: Is there much regulatory appetite for potential JV immunization with **Chinese** carriers?

JEFF SMISEK: Jamie, this is Jeff. We're not going to be able to get JVs with, for example, our partner in **China**, until **China** goes open skies. As that--

JAMIE BAKER: Right.

JEFF SMISEK: But whatever period of time it takes. Clearly, that's something we would be keenly interested in, where we'd have the regulatory authority to do that, but we don't have that yet.

JIM COMPTON: And I would add to Jeff's comments, working with Air **China**, some of the success of Chengdu being ahead of our expectations is the connections that they're building for us in Chengdu. So we'll continue to work with that from an alliance perspective with our Star partners.

JAMIE BAKER: John, Jim and Jeff, I appreciate your answers. Take care.

OPERATOR: From Wolfe Research, we have Hunter Keay on the line. Please go ahead.

HUNTER KEAY, ANALYST, WOLFE RESEARCH: Hey, thanks very much. Hey, a question for John. I don't mean for this to sound antagonistic at all, I don't, but I can't think of another way to ask it. If a **company** doesn't qualify for hedge accounting, doesn't that mean that the **company** is just speculating with commodity derivatives that don't correlate to the price of the commodities that they use?

JOHN RAINEY: Not necessarily, Jamie. The accounting rules are around getting hedge accounting treatment. I'll give you one example. If you don't have an equal number of bought and sold, call and put positions, that doesn't allow you to get hedge accounting. You have to -- so for example, if you did a collar, a bought call and a sold put, you get hedge accounting, but if you were to then go out and mitigate the cost of that by selling a call at the high end, say \$140 of Brent, that precludes you being able to get hedge accounting.

I'll tell you that our hedge philosophy here is one of risk management. This is our single largest expense that represents \$12 **billion** to \$13 **billion** for us annually. We think that taking some risk off the table in the near-term is a prudent thing to do. We've had this discussion before with you. I know that, philosophically, we agree that, long-term, the industry needs to be able to adjust capacity and, therefore, its prices to compensate for its price inputs. Given the nature of our business, that we sell tickets 330 days in advanced, that we schedule employees for many months in advance sometimes, it's difficult to adjust capacity in the very near-term, which is why our hedge position is more heavily weighted, close in.

HUNTER KEAY: Okay. Thank you, John. I appreciate that. And a little bit more on the previous question. In terms of open skies with **China**, Jeff, do you believe that a pacing item for open skies to occur -- because if you look at prior open skies agreements with the Japanese and with the EU, it's some sort of free market concept for slot-controlled airports. So is it fair to assume that we should pretty much never assume **China** is ever going to grant open skies because they're not going to relinquish control over slots at Beijing and Shanghai?

JEFF SMISEK: I don't know. It's a good question, Hunter, and I don't know the answer to it. That's going to require work by US carriers pushing our own government to be flexible and to make sure that there are a fair allocation of slots to US carriers and that's, as you allude to, our government's experience with Japan, in particular, with Haneda, is a good example of that. That's a difficult process. What -- I wasn't predicting necessarily a near-term open skies agreement with **China**. I was just saying that if there were one, it would be necessary. That's a predicate to having a joint venture.

HUNTER KEAY: Thank you very much.

OPERATOR: From Deutsche Bank, we have Michael Linenberg on the line. Please go ahead.

MICHAEL LINENBERG, ANALYST, DEUTSCHE BANK: Good morning, guys. Just a couple here. Jim, appreciate that you gave us the quarterly PRASM guide and highlighted the headwind. Can you give us,

maybe, an early read on October? And I'm asking because I know last year we did have the government shutdown, and as I recall, that was -- maybe it was 1 point, 1.5 point headwind. Any color on October, how things are shaping up?

JIM COMPTON: Hey, Mike.

MICHAEL LINENBERG: Hey.

JIM COMPTON: We don't comment on a specific month, but you're right, just in terms of last year with the government shutdown, the beginning of the month and then it's coming back about October 16 last year, there was clearly, from a government traffic, as well as business traffic associated with government-type fares, strength year-over-year in that area and we did see that so far in October. We're now back to year-over-year where the government shutdown was over.

MICHAEL LINENBERG: Okay. Great. And just my second question, on the seasonal shaping, as we move into the early part of 2015, conceptually, it does make a lot of sense, to really ramp up when demand is strongest. But given the adjustments there on capacity, you highlighted the trans-Atlantic numbers, can you talk about just some of the potential execution risks here? Is this -- could we see this go very wrong or do you feel like you have the systems, the controls, the ability to move people around?

I know there have been some structural changes, like on how you staff up at airports, for example, and the way some of the new contracts have been structured. Just highlight some of the things that we should be looking for so that we know that -- to go from X to X plus 20% on capacity in particular markets, that you're operating well?

JIM COMPTON: Mike, this is Jim again. What we're doing with the seasonal capacity change is a process internally that we started a long time ago. By that I mean, the network planning group has worked hand-in-hand with our operations folks. Because you're right, there is a lot of coordination in terms of having utilization of the aircraft there, the crews, and so forth, and the ability for the stations to handle the schedule.

So we're really confident where we're at in it because the process began a long time ago and we're right on timeline for the execution to go very well. And we're excited about it because, obviously, that peak summer demand will drive the full year. We talk about adding a 0.5 point of PRASM to our trans-Atlantic entity into 2015 with this network change that we're doing.

MICHAEL LINENBERG: Okay. Very good. Thanks, Jim.

OPERATOR: From Morgan Stanley, we have John Godyn on the line. Please go ahead.

JOHN GODYN, ANALYST, MORGAN STANLEY: Thanks a lot for taking my question. Just one on costs and one on capacity. First on costs, John, you had some good commentary about how you're tracking versus the cost reduction plan that was announced toward the end of 2013. I'm curious if you could just speak to whether opportunities are being pushed forward or outright upside to the plan is being created and how we might revise the \$1 billion fuel and \$1 billion ex-fuel numbers, if in fact there is now upside being found?

JOHN RAINEY: John, it's a good question. I would characterize our progress thus far as really more the opportunity has been greater than what we expected on the initiatives that we've embarked on, rather than sliding forward initiatives. There have been some exceptions, but those go both ways. When you get into this, some things take longer than you expect and some things you can accelerate.

But generally, what we've seen is where there have been opportunities, we've exceeded our expectations and I really credit the employees for this. This is, just across the board, you see every single work group, where there's a real drive for efficiency. I'll give you an example. In the third quarter, overtime in our maintenance group was about 2 points better year-over-year and that doesn't really mean much just in terms of dollars in that statement, but 1 point overtime change for maintenance is about \$10 million to \$12 million annually.

This is just really running a better, more efficient operation and you see that in the bottom line. And that's one example. We see it in our res group, we see it in our airport groups. We've got better staffing with our flight attendants. They're really a huge drive across the Company and clearly everyone is on board.

JOHN GODYN: And if this is really a momentum and a cultural dynamic in the background, it sounds like it could last even for the next few years. I wonder, is it possible that by the end of this plan, we find that we're hundreds of millions of dollars above the \$1 billion ex-fuel and \$1 billion fuel that you outlined at the end of 2013?

JEFF SMISEK: Hey, John, this is Jeff. One of the things -- the point you make is a very good point. One of the things, this Project Quality is designed to deliver \$2 billion of efficiencies to cost savings by 2017, but it's not going end in 2017. What we're instilling here is a culture of efficiency and continuous improvement something that this industry has woefully lacked, candidly.

This is the first step of what we're doing. We have a lot of confidence in achieving the goals that we set forth in November of 2013, but it won't stop in 2017. This is a way of thinking. This is a way of questioning how and why we do things and how we can do things more efficiently, better for our employees, better for our customers, and clearly better for our bottom line.

JOHN GODYN: Got it. And if I could just ask a question on capacity. Jim, you offered a lot of tactical commentary in the short-term about how you're managing different market dynamics, but when I think about the 2015 guidance and the fact that you're still growing a bit faster in international than in domestic, I just wonder is there appetite for maybe more structural change to how you think about international versus domestic, because you're [overweight] position in international still comes up as one of the largest risk factors, at least in my conversations with investors?

JIM COMPTON: Hey, John, this is Jim. The capacity guidance -- let me put a little context around the international piece of 2015, because as we've talked a lot about, the seasonal shaping of trans-Atlantic,, that really implies really low single-digit capacity growth for the Atlantic entity in 2015. As you think about Latin America in terms of routes that make a lot of sense for us to complete our portfolio, we are beginning this year adding Houston to Santiago. It's for a long time been a big ask from our corporate partners to serve that market, so we're really excited about it.

So 2015, in that sense, becomes a run rate of that new market that we're very excited about. So it's very strategic in terms of what we're trying to do from a business side. We also are starting in this year Denver to Panama, and so the run rate of that market is also into growth. And then the rest is, what I mentioned in my script, is we're seeing really strong demands in the beach markets.

For instance, we can take a Chicago-LaGuardia trip on a Saturday and fly from Chicago to Cancun on that same Saturday and we'll -- it generates incremental capacity into Latin America, but from a margin perspective, it's actually very accretive. So the way we think of this all is in the context of what we're trying to do strategically: be capacity disciplined, build on our strengths, and do that with different levers. One of the levers is some of the seasonality. When you think about the Latin, you get into mid-single-digit type of growth in that area with what I described.

In the Pacific, just to close that out, we're really excited about starting LA to Melbourne this year and you're going to have the run rate of that. And again, it's as much about ultimately getting out of our tag Sydney to Melbourne that is very expensive for us to operate, but allows us to serve Melbourne. The 787-9 becomes the great airplane [to solve] that will have that run rate capacity in there.

And then we have the run rate of San Francisco to Chengdu and San Fran to Taipei capacity, that I've already noted is running ahead of expectations. That gets us in the mid-single digits in the Pacific. So the international capacity we think fits very well with our capacity discipline, although because of the run rate and some of the things we're doing in the beach markets, generates a capacity next year at the level that maybe you're inferring.

JOHN GODYN: Okay. Thanks for the color.

OPERATOR: From Credit Suisse, we have Julie Yates on the line. Please go ahead.

JULIE YATES, ANALYST, CREDIT SUISSE: Good morning. Thanks for taking my question.

JIM COMPTON: Good morning, Julie.

JULIE YATES: I realize it's a little early to be giving 2015 cost guidance, and you guys are still in the middle of your budgeting process, but from a high level, how should we be thinking about the non-fuel unit cost growth in 2015, especially in light of the fact that Project Quality seems to be doing a little bit better than you originally expected?

JOHN RAINEY: Julie, we've characterized our cost goal as being one where we expect to grow non-fuel cost at something less than inflation. I appreciate that's a little bit vague as inflation can bounce around. It's a long-term goal, and we may see that 00 we may see cost pressures from one year to the next, which will cause that to vary. We are, as Jim alluded to, growing more next year than what we did this year.

It's obviously easier to keep that number lower as you're supported by some growth, so we're sticking to that goal. We'll give more clarity over the coming quarter about what our 2015 [number] is, but we're extremely encouraged by the early progress that we've seen this year. I talked about in my prepared

remarks the fact that, despite capacity coming down a full point versus our original expectations, we've been able to hit our cost goals. So I expect that to bleed over into 2015 and the same performance that we've seen this year will continue into the next year.

JULIE YATES: Okay. And then just a follow-up on labor. Is there any update on reaching a single contract with either the flight attendant or the technician group?

GREG HART: Hey, this is Greg. We remain in negotiations with our flight attendants. I'm sure you all saw that we went on an early out program with our flight attendants, which has been very, very well received and we hope that is a bridge for an agreement with our flight attendants, which we expect to have happen some time next year. We are still working with our technicians, and obviously, are very focused on getting a deal done with those folks as soon as we can, as well.

JULIE YATES: Okay. And then how much of a tailwind on the labor productivity is it to reach the single contract on the flight attendant side?

GREG HART: I'm not sure I understand your question, Julie.

JULIE YATES: Once you get to single contract with the flight attendants, I would imagine that you'll be able to recognize greater labor productivity from staffing?

GREG HART: Right. The specifics of the contract are still -- we're still working on. Obviously, we -- there are some inefficiencies just in our system today by having two separate collective bargaining agreements, with the inefficiencies of staffing, transportation costs, hotels, things like that, so we do expect some benefit from that, but we haven't necessarily quantified that.

JULIE YATES: Okay. Thank you very much.

OPERATOR: From Evercore, we have Duane Pfennigwerth on the line. Please go ahead.

DUANE PFENNIGWERTH, ANALYST, EVERCORE PARTNERS: Good morning. Just a couple of fuel questions, if I could. This move down we've had here \$2.90 to \$2.40, \$2.50 [jet] before taxes and fees, pretty sharp move. How has that changed your plans, if at all, for 2015, or maybe for the fourth quarter? Does that relate at all to the stage length increase, which is probably implied by that fuel efficiency? And then could you just give us a sense for where you are from a hedge book perspective and the degree to which you're participating in this downward move into 2015?

JOHN RAINEY: Sure. Let me take the last part of your question first, if that's okay. For the fourth quarter, we're 39% hedged, and over the next 12 months, we're about 35% hedged. In terms of our participation, in the fourth quarter, we are participating about 70% to the upside and the downside in fuel movements, and for the 2015, that's more like 80%. So hopefully that helps.

In terms of our hedge strategy, our hedge strategy is -- part of it has been to be responsive to the overall fuel market. Over the last few years, you've seen that fuel has been relatively [range bound] and our hedge portfolio has reflected that fact we fared better than any of our competitors over that period of time. We've seen fuel break out of that range and we're very early on in this. We will look to see if it stabilizes and a new trading band develops and then our hedge structure will respond to that.

DUANE PFENNIGWERTH: Okay. Thanks. And then maybe I missed it. Have you offered CapEx guidance for next year yet?

JOHN RAINEY: We have not. We did talk about, at investor day last year, Duane, our long-term goal of about \$2.8 billion to \$3 billion over the next few years. We have made some changes. I talked a little bit about some of the changes we've made from a fleet perspective, so that -- we would expect that number to move around a little bit, but we'll give you more guidance on that as we get closer to year-end.

DUANE PFENNIGWERTH: Okay. I assume -- it sounds like -- correct me if I'm wrong, it sounds like that pushed some aircraft out, so maybe the bias on that is down. And then just lastly on the buyback, when you initially announced it, \$1 billion over three years and you've taken down over \$200 million in the first quarter, so it looks like you'll finish that in a year. Can you just give us a sense for when you would choose to update us on the authorization and how we should be thinking about that timing?

JEFF SMISEK: Well, we're going to take this in steps, Duane. I'm pleased at the fact that we're almost one-quarter of the way through this early on. We've seen a lot of volatility in the market and it has created some buying opportunities for us. We still think this is a great way to return cash to shareholders, given where our stock is trading right now, but I've emphasized before, this is a first step, and when we complete this or get close to completion, we'll come back to the market with our next step, but I'm not prepared to talk anymore about that, at this point in time.

DUANE PFENNIGWERTH: Okay. Thanks for taking the questions.

JEFF SMISEK: You bet.

OPERATOR: We have time for one last question. And from Barclays we have David Fintzen on the line. Please go ahead.

DAVID FINTZEN, ANALYST, BARCLAYS CAPITAL: Hey, thanks. Good morning, everyone. Maybe a question for John. I appreciate getting a little ahead of 2015 here, but if I look at your absolute non-fuel growth, the last few quarters, you've kept it right around 1% if not below in some quarters. As we get out to 2015, and obviously there's a lot to go on Project Quality, are there some other inflationary cost pressures that pick up in 2015 versus 2014 that would materially start to change that absolute cost profile? I'm just trying to think through some of the moving pieces into next year?

JOHN RAINEY: Good question, David. There are a couple of headwinds. I do not expect it to change that profile. The best example I can give you right now relates to pension. The discount rate that we use today to discount the liabilities in our pension is about 5.1%. The preliminary look for next year, it looks like it will be closer to 4.3%, so that will create between \$50 million and \$100 million of headwind for us next year.

There's also an update to the mortality tables for pensions, which is not reflected in our current numbers. But that said, even with those headwinds, we expect to receive the type of cost performance that we've outlined, so I don't expect it to change the profile that you alluded to.

DAVID FINTZEN: Okay. That's very helpful. Then maybe a quick one for Jim. On the Chinese capacity growth, it's obviously coming from a lot of arguably lesser-known brands from a US perspective. How effective are some of these carriers at competing in the US point-of-sale?

JIM COMPTON: Well, clearly their point-of-sale is more Chinese point-of-sale and -- but I liken -- every competitor is a good competitor and, our goal in competing is obviously operate at a really high reliability rate with a great product and -- but our point-of-sale on the US side is stronger than the Chinese point-of-sale and you have that dynamic for them also, on their side. Clearly, you're right, they're building a brand presence as they grow their presence into the US and so United, since 1986, being in the market in China, has a strong presence over there to date.

DAVID FINTZEN: Okay. That's very helpful. Thanks, everyone.

JEFF SMISEK: Thanks, Dave.

OPERATOR: Thank you, ladies and gentlemen. This concludes the analyst and investor portion of our call today. We will now take questions from the media.

(Operator Instructions)

From Thomson Reuters, we have Jeffrey Dastin on the line. Please go ahead.

JEFFREY DASTIN, MEDIA, THOMSON REUTERS: Hi. Thank you for taking my call. Could you elaborate on the 787-10 conversion? Will there essentially be deferred 787 deliveries?

JEFF SMISEK: Our current plan is to defer the deliveries that we expected to take in 2017 and 2018 into 2022. We still do hold option positions. Jim alluded to the fact that fleet flexibility is something that's very important for us to be able to respond to the economic environment, yet still do so in our capacity-disciplined manner, but that was the move that we recently made, yes.

JEFFREY DASTIN: Thank you.

JEFF SMISEK: You're welcome.

OPERATOR: From Flightglobal Media, we have Edward Russell on the line. Please go ahead.

EDWARD RUSSELL, MEDIA, FLIGHTGLOBAL MEDIA: Could you elaborate a bit more on the -- looking at use of aircraft, first of all, where the 737s you purchased are coming from? And then also, are you looking for narrow bodies or wide bodies? Thank you.

JOHN RAINEY: Sure. The 737-700s that we obtained were from a leasing company. I don't want to comment any further on the airline that they came from. But the other part of your question, at this point we're really more focused on narrow body lift. Part of the issue that we're solving for is today we are too reliant on the 50-seat RJ. It creates some operational complexities, but there's also a looming shortage with respect to pilots being able to fly some of those, as we look at some of the changes in the training requirements.

So what we want to do is backfill some of that capacity in a financially disciplined way. We don't necessarily want to go out and place a brand new aircraft order that creates several **billion** dollars more of CapEx. We've talked a lot about having a balanced allocation of cash flow. So this is a way, by looking at the used aircraft market, that we can still backfill some of that capacity, more narrow-body focused, but do it while still addressing the other cash flow needs that we have.

EDWARD RUSSELL: All right. And can we infer to say you're looking for aircraft that are currently in your fleet or models at least?

JEFF SMISEK: That's accurate. Any time you look at adding a plane or new fleet type, there's some complexity with that. There has been some discussion about the 190s. That's something that is on the radar, candidly, as well, but certainly if you look at our narrow body fleet with the Airbus A319s, A320s, the new gen 737s, those are all planes that fit the profile that we could easily accommodate into our fleet.

EDWARD RUSSELL: Great. Thank you.

NENE FOXHALL: Okay, thanks, everybody. We'll conclude now. We appreciate you all joining us on the call. Please call media relations if you have any further questions and we'll look forward to talk to you next quarter.

OPERATOR: Ladies and gentlemen, this concludes today's conference. Thank you for joining. You may now disconnect.

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