



First Half 2015 Results Presentation

24 July 2015

Transcript

Introduction - Alexandre de Juniac - Air France-KLM - Chairman and CEO

Ladies and gentlemen, thank you very much for coming this morning. Thank you for those who are connected through the telephone or Internet. Welcome for this first half 2015 results that we will present, Pierre-Francois Riolacci and I. We will divide our presentation into two parts. First of all, Pierre-Francois will comment on the figures and I will, after him, make a quick update on where we are in terms of the rollout of Perform and about our strategy.

Pierre-Francois, you have the floor to start with the comments on numbers.

Results - Pierre-Francois Riolacci - Air France-KLM - CFO

Thank you, Alexandre. Good morning to all of you. I will jump right away into the presentation and invite you on the phone to look at page 3 and start with some highlights. We had actually a mixed environment. On the economic side, it was not too bad and, definitely, North America is doing well, supported by the strong US dollar; no surprise. Most of the economies in which we operate are stable and we have, however, some issues. One is Brazil, which is definitely not recovering and we have no sign of improvement in Brazil. And also, more generally, the oil and gas routes which are under pressure. Basically in each country which is very much dependent upon oil price, you see a significant decline in demand.

On the political side, there was again some heavy turmoils. Definitely the North Africa is a tough area and it hurts mainly Transavia. But also Japan has not recovered and the traffic between Japan and Europe has not recovered from what happened in the beginning of the year. The good news is that the Ebola impact is now fading away and in June it was even difficult to find any track of further disruptions linked to Ebola.

We had high volatility in fuel price and also in forex, and now you definitely need to look at both unit revenue development in nominal -- in current terms but also excluding rox [rate of exchange]. You need to look both to give you an idea during -- if you look just at the unit revenue for the passenger business, it was up plus 2.2% in the second quarter where it was plus 1% in Q1. And excluding rox it's down 4.8% where it was down 2.3%, so you see really different trends and that's, I think, an important takeaway.

However, during -- despite this environment, we had some significant achievements on the strategy and the restructuring, and also on Transavia, and Alexandre will elaborate on these points. One which is very important for me, as you can imagine, is the cash generation and the debt reduction which has been achieved during this second quarter and the first half of the year.

If you look at the key data [slide 4], you see that revenues during the Q2 are up 3% and down 4.5%, excluding rox, so there is a clear downturn between Q1 and Q2 in the unit revenue, excluding Forex. The Forex impact in the quarter is EUR500m for the revenues. Significant negative Forex impact on the operating KPIs while the fuel advantage is clearly handed over to our customers the unit revenue decreased.

The debt is down to EUR4,550m despite a negative Forex impact, despite some operating leases that we have decided to move back onto the balance sheet, and this is on the back of very strong cash generation, nearly EUR300m, plus a financial operation that we have completed during this first half of the year.

About Forex [slide 5], you know that we have about 25% of the revenues which are denominated in US dollars. Another 25% is denominated in different currencies; GBP, Japanese yen, Chinese yuan, etc., but

we have also 42% of our costs which are denominated in US dollars, mainly fuel but also aircraft leases. So if you look at what happened during the second quarter, we had a positive impact on the revenues for EUR507m, mainly passenger (PAX) business, but also in MRO and cargo, accelerating from Q1 due to higher volumes also because the tickets, which are now being accounted in revenues, have been actually issued in Q4/Q1 where the US dollar started to increase so it's pushing up. But we had also, in the same time, a very significant Forex impact on the cost, EUR561m, mainly on fuel.

If you look at the different segments [slide 6], I think that I will elaborate on each of them. You see that PAX operating result is flat in the PAX business, like-for-like, ie excluding Forex. I think that you see that all the other operations are more or less stable or even definitely improving, like maintenance. The key issue for us during this quarter was cargo where we've had a very tough environment. We'll elaborate a bit more on that.

On the PAX side [slide 7], you see that we maintain a very strong capacity discipline with ASKs up 0.4%; I will detail that a bit. The unit revenue is up 2.2%. You see the impact of the Forex, which is very significant, and I will again detail per region the different trends. You see also that the front cabin is doing a bit better than the eco with unit revenue in premium down 3.5% where unit revenue in eco is down 5.8%. One word about the CASK, which is up 3.3% and there you see again the impact of the US dollar. Excluding Forex, it's down 4.9% and you can see here the impact of the lower fuel price.

About capacity [slide 8], you see that, in the last three quarters, we've been very, very disciplined with stable capacity, even negative in Q4. You see also that the trend in unit revenue excluding rox is definitely deteriorating but, again, there is clearly a shift between the value in the rox and the valuation of the unit revenue, excluding the rox.

If you look at the overall map [slide 9], on long-haul first, you see an increase during the quarter of the ASKs of 1.4% where the unit revenue is down by 5.5%, excluding rox. What is above the average? Definitely Caribbean and Indian Ocean, which are doing very well, but also North America. You can say North America is deteriorating at -2.9%, but actually it is very positive including rox. So North America is doing well. We are shifting obviously our sales towards the US market and we accept to sell at a lower yield in the US market so it has a negative impact on the unit revenue, excluding rox, but, of course, it's still a good bargain because we benefit from the strong US dollar.

For the rest, you see the consequences of oversupply, especially in South America where the unit revenue is down nearly 14%. This is pretty much on the back of Brazil. The rest of the continent is doing okay with the exception of Colombia so it's definitely a Brazilian issue and we will have to take actions to limit the negative impact of this weak demand.

On Asia/Africa, you see that unit revenue is down minus 6%, minus 7%, excluding rox. You see again the issue of oversupply from the Gulf carriers but also the weak market in Japan, which is hurting us, and also the political unrest that we have in East Africa and the oil and gas routes, which are very important, in Western and Central Africa.

One point which is worth to be noted is the medium-haul point-to-point business where we are carrying on the restructuring of the network. Minus 14% in ASKs and you see that it is strongly accretive on the unit revenue, plus 8% on the back of the restructuring but also because we are doing a lot of efforts which are paying off in terms of marketing.

On cargo [slide 10], I mentioned that it was a tough quarter, definitely. We have been moving ahead with the restructuring. The full-freighter capacity is down 26% quarter to quarter in one year's time. Including

the bellies, the capacity on cargo is minus 5.7%. The unit revenue is down 4% and even minus 14% excluding forex.

You may remember that, a few months ago, we had some pick-up in the demand in Europe; we've seen that vanishing in the air and today's demand in Europe is pretty idle. On top of that, we have some competitors -- full-freighter competitors -- which are not basically hedging their fuel so they have the capacity to transfer to the market, faster than the usual operators, the lower fuel price and probably it is accelerating the trend; hopefully it will stop a bit earlier than for the rest of the business.

The good news is on the unit cost, which is down 8.5% excluding rox but including fuel. Excluding fuel, excluding rox, we still achieve a decrease in the unit cost of about 2% which, in the context of decreasing capacity, is quite an achievement.

The top priority of the new cargo management is definitely to execute the restructuring of Schiphol operations. It's done in Charles de Gaulle. It has to be done at Schiphol; and also to focus the organization on efficiency and including the revenues and notably the load factor.

After cargo, maintenance [slide 11] is definitely much brighter. Basically, everything is good in maintenance this quarter. Third party revenues are booming with obviously the booster of the Forex. But even excluding Forex, we have a strong double-digit growth in external revenues in E&M (maintenance), with an order book which is further increasing. From now on, we will present you the order book in US dollar because if it was in euro it would be including even much more and you know that it is a dollar business.

The improvement in the Forex is also helping the margins because we have more than 30% of costs which are still in euros, so definitely a well-oriented business. I'm not saying that we'll do the same performance in the next quarters but we expect a good year in E&M; that's for sure.

On Transavia [slide 12], if you look at the global story, we have capacity which is up by 7%, with the number of passengers up by close to 9%. You need to look differently at the Netherlands and France. In the Netherlands, we carry on shifting the model from a charter/B2B business to a pure low-cost model. We are moving on. ASKs are down 2% because of this switch. The unit revenue is more or less stable and the unit cost is slightly down, 2%, stage-length Alexandre de Juniacusted and excluding fuel.

You remember that Transavia Netherlands had a tough beginning of the year last year. It's getting better; it's being fixed. And they have also signed a new Collective Labor Agreement, which is very encouraging, and which paves the way for further growth at Transavia Netherlands. That's really good news.

At Transavia France, it's a totally different story. You know that we are increasing a lot the capacity, plus 22% during the quarter, and we delivered this increasing capacity. It was tough on unit revenue development during the second quarter. Of course, the low-cost market is competitive, especially on the south of Europe, in Spain and Italy. But what was really difficult was North Africa, as Alexandre mentioned, because North Africa accounts for more than 35% of the market of Transavia France, especially Tunisia and Morocco, and Tunisia has been badly hit by the events that occurred earlier this year.

So [Transavia France] unit revenue, stage-length Alexandre de Juniacusted, is down 13% during the second quarter while the unit cost is down 3% on the same basis. It means that we will also change (and we are doing it already) the network of Transavia France to adapt and that's one of the assets of the low

cost model: it is more nimble than full-service carriers and we can adapt the network much more efficiently than we will do in the mainline.

On the cost side [slide 13], you see that our operating costs, excluding fuel and Forex, are up on this quarter by 1.3%; that is about EUR60m. The EUR60m are 100% linked to the increase of third party sales because you know that in our business we also sell to third parties in some of the B2B activities, E&M mainly and catering to a lesser extent. I will comment in detail on the employee cost performance side.

To read this table you need to factor in the change in accounting that we made since the beginning of the year, which is that now the nature of cost is shown on each line and then what is capitalized in our balance sheet is shown within the line "other income and expenses". So it means that you have the total cost, which I've shown in each and every line, but you have a profit to P&L, or less charge, which is recovered in the other one. That's very important, especially, for example, if you look at purchasing of maintenance services and parts, which is up 15%, it actually also includes all the work that we do on our cabin reconfiguration and which is then capitalized on the balance sheet, so that's very important if you want to read carefully this table.

On the fuel bill [slide 14], it's pretty stable actually, quarter to quarter, which is a bit of a surprise given the magnitude of the change. But you see that we had a strong decrease of the market price, which is mitigated by the hedging. You see that losses on hedging are now starting to be smaller than in the first quarter and it will obviously carry on that way. So the net impact of market minus hedging is increasing over the quarters. But we have also a massive impact which is linked to the euro/dollar, no surprise, so at the end of the day, the fuel bill is pretty stable in this quarter.

For the full year [slide 15], we expect the fuel bill to be in the region of \$7.1b, which is strongly down, obviously, compared to last year. It's spread more or less evenly during each quarter. This forecast is based on the forward curve. So you know that the forward curve has some contango and is increasing so, hopefully, the spot price, everything being equal, will help us to be a bit lower than that. You see also that we have a significant upside coming in 2016 when the hedging is actually moving away.

On the labor costs [slide 16] a significant decrease in the headcount. It was expected with leaves and the Air France Voluntary Departure Plan (VDP) that incurred in Q2, excluding scope because we bought some subsidiaries in -- and minority interest in Servair, in particular, but also Barfield [a US maintenance business]. Excluding the change in scope, the restructuring has led to exit nearly 2,000 FTEs during this quarter, so quite an impressive number.

However, you see that the labor cost is pretty stable. This is on the back of pension-related expenses. You remember we explained that, due to the lower discount rate that are recorded in the balance sheet, the pension charge in the P&L -- without cash impact -- at KLM would increase by about EUR120m for the year so that's about EUR30m for the quarter. And on top of that, we still have some pressure on unit costs per FTEs, which is due partly to higher activity of Air France pilots, partly to some inflation in the CLAs that prove that we need to be very strong in the discussion on freezing salaries and I think that KLM achieved quite something in the latest agreement from that regard.

We have also during the first half provisioned some restructuring costs. At Air France, about EUR60m, which is linked to the VDPs which have been announced for 800 people; at Martinair, about EUR40m linked to the pilots who are leaving the Company; and at KLM itself, EUR30m for again a bit more than 300 people. This has been accounted at June end.

In the operating result [slide 17], which is down by about EUR50m, you clearly see that the fuel price benefit has been shifted to the market for unit revenue development. I think that the chart is pretty simple.

We have a negative impact of currency for about EUR50m, which is broadly what we lose on the quarter on operating income. You see that unit cost contribution is picking up but it is offset by the change in the pension charge that I just mentioned.

In terms of unit cost [slide 18], we report a 2% increase. Corrected from currency, fuel and pension, it's actually down 0.5% in the quarter, which is an improvement compared to Q1. And we are on track with an increasing unit cost reduction through the quarters with a full-year objective which is, as you know, 1.0% to 1.3%, even if the lower capacity that we have for the fourth quarter will take us probably at the low end of the range; but we are on track with our initial plan in managing costs.

On the cash side [slide 19], I think it was definitely a good beginning of the year with operating free cash which is EUR274m; it was EUR95m last year. Two things that I would like to stress. First one is that we have a very strong working cap which is a very good one because it's based on advanced ticket sales running at a very high level. So we have already some advance for the third quarter, which is good. I hope that we'll be able to maintain part of this advance at year-end. We shall see, but definitely a good performance in this quarter. And also, on the Capex side, you see that we are growing slightly the gross Capex on EUR835m last year to EUR870m but to a very limited extent, so Capex are well under control.

We had some non-monetary events on the net debt. I mentioned the Forex. We have some debt in Japanese yen, Swiss franc and, to a limited extent, in US dollar. This costs us about EUR150m in Forex impact on the debt. We have also put back in the balance sheet some operating leases that we had in Air France for EUR130m so it does impact negatively the debt as a whole for EUR350m. But, on the other side, we have disposed of Amadeus shares for EUR327m and we have issued the hybrid for EUR600m. So the total debt is down by EUR850m to EUR4,550m at the end of June. [Slide 20] It's a further decrease of the debt compared to where we were two, three years ago, minus EUR2b and we are on track to get to our target of EUR4.4b at year-end.

Just a word about pensions [slide 21] because it was a question during the first quarter. We have been helped by the higher long-term interest rates that we have recorded at the end of the quarter. So you see that now the change in actuarial assumptions, compared to December 31, is very small. But, at the same time, we had a good performance of our assets; therefore, the balance that we have at the end of the year has been reduced by close to EUR400m. It's now sitting at minus EUR340m at the end of June, which offers us a very strong funding ratio. So I think that our pension situation, compared to many competitors, is not bad at all.

Liquidity [slide 22] is strong. We have completed some financial operation which obviously helped to improve the cash position. We've refinanced our debt, as well. You see also that both Air France-KLM and Air France on the one side, KLM on the other side, have successfully managed to renew their credit facility for the next few years so I think that on the liquidity side we've already passed the key steps that we had to go for, for this year.

So with the lower debt we further improve our credit ratios [slide 23]. We are, again, on track towards their reduction. Most important for us is the Alexandre de Juniac net debt to EBITDAR which is showing some further progress towards the 2.5x target that we have for 2017.

That's it for the numbers for the first half of the year.

Strategy and update on Perform 2020 - Alexandre de Juniac

Thank you very much, Pierre-Francois. I will make a quick update on where we are in terms of strategy and the implementation of our Perform 2020 plan. The two ideas I would like to convey to you: first of all,

we are perfectly on track on the rollout and implementation of our Perform 2020 plan as it was designed in January. But, second point, due to the difficult market conditions, the pressure of the competition and pressure on unit cost, we have had to accelerate and amplify the cost and competitiveness part of this plan.

So, first of all [slide 25], we are on track on the plan we had designed in January 2015 on three elements. First of all that our growth initiatives are perfectly on track and we are facing strong momentum on these items. Secondly, our cost initiatives are under implementation and we have made, on both sides, particularly KLM, good progress on the renegotiation of collective agreements.

On the growth side, I would like to focus on three elements.

First of all [slide 27], our investment in products and services are very well received by customers and I would like to say that our new products and services, both at KLM and at Air France, are at the top level -- when we compare to competition. For long-haul, almost a third of our fleet is now equipped with the new World Business Class at KLM and the "Best & Beyond" product at Air France. You see on the right part of the page 27 the significant, enormous improvement in terms of Net Promoter Score satisfaction index, that is probably the best measurement of the satisfaction of customers.

For the medium-haul in Europe for Air France, we have launched also a new upgrade program. Again, in the bottom right part of the slide, you see that's a major improvement in customer satisfaction for this new product and service. And we have been awarded at Air France a Skytrax prize to be the world most improved airline in 2014, so it means that these product that have received an enormous program of investment, accounting for almost EUR1b in five years to improve our product, is having very, very good results with our customers and it's a key issue, as you know, for us.

Second point on Transavia [slide 28], which was the second part of our growth plan. You see that we are perfectly on track in terms of growth for Transavia, particularly on the French part, because the Dutch part had to implement a restructuring plan and a shifting plan from a tour operating-based business to a more classical, low-cost business and they have done that successfully with no growth but they have also implemented successfully a restructuring plan and a renegotiation plan with their personnel.

You see on the right part of the page 28 that we are perfectly on plan in terms of growth. Between the first half of 2014, 2015 we will have grown by 10% and we target more than 16m passengers in 2017 with 65 aircraft. We have also invested a lot in renewing the commercial positioning, in a new website, a new digital platform, new branded fares, so I strongly encourage everyone in this room, on the phone and on the web to fly Transavia. You will be more than satisfied, and use our new commercial features. On Transavia outside the French and the Dutch borders, we have relaunched the discussions with the various social stakeholders, including the pilot unions, and so we will implement these discussions in the coming weeks, and we target a growth outside the Dutch and the French borders by summer 2016.

Third point for growth, it is maintenance [slide 29]. As Pierre-Francois mentioned, it has improved significantly. It was one of our growth target in the Perform 2020 plan. You see that in dollars, between December 2013 and June 2015, the order book increased by 44% and it represents now \$8.5b accounting for almost five years of turnover. In terms of external turnover and profitability, right part of this slide, you see that we are targeting in 2015 something which is significantly higher than in 2014 with a strong profitability.

So in these three areas, maintenance, Transavia, products and services, we are doing the job as we committed.

On the cost reduction part [slide 31], all the initiatives to deliver what we indicated at the beginning of Perform 2020 are on track. We said that we will reduce our unit cost by 1.5% a year on the next three years, 2015 to 2017. It represents EUR0.54 cents per EASK, which is the synthetic KPI grouping bellies and seats. And it represents in terms of money an equivalent of EUR1.8b in terms of cost reductions for Air France-KLM.

You see on the right part of page 31, the various items that are included in the Perform 2020 initiatives, representing EUR1.8b. Almost 45% are non-labor-related cost reduction measures and 55% are labor-related cost reduction measures.

On the negotiation part [slide 32] which is in our business, as you know, a key element, on both sides in KLM and in Air France, you see that we made significant progress at KLM. All the negotiations have been successfully concluded with the ground staff, with cabin crew and with pilots, for ground staff for 18 months, for cabin crew 15 months, and for pilots three years. And so, we are targeting in second half of 2015, the implementation of this agreement first of all and secondly, the relaunch of the negotiation with the cabin crew and the ground staff to cover the second part of the three-year usual agreement we have with our Dutch employees.

At Air France, the negotiation has been opened at the beginning of May, because you remember that we had social elections inside Air France, so it explains why it started four months later than at KLM. Negotiations are ongoing in, I have to say, in a positive atmosphere, especially with our pilots. You may have noted that we have concluded two agreements with them in the past days and that we are expecting in the coming days/weeks a positive issue on the implementation of the Transform measures that were still under negotiation with them. So things are moving in the right direction.

We have launched various cost reduction program. I would like to give two examples.

First of all for Air France [slide 33], we have accelerated the HOP! Air France restructuring part by merging the regional operating carrier, Brit Air, Regional and Airlinair; by pushing on the Voluntary Departure Plan that are also ongoing for cabin crew and for ground staff; by renovating our commercial offer; and by trying to manage, to optimize even more the fleet management that we have for this unit. You see that we are perfectly on track to target as we committed a breakeven for this part of the Air France network in 2017, right part of the slide.

Second example [slide 34], we have launched a major initiative in the reduction of G&A expenditures. As you see, we have a base for Air France-KLM of G&A cost of EUR1.5b that is split between the various cost centers that you see on the right part of this slide. We are targeting to reduce that by something around EUR300m. We have already identified EUR150m and we are working hard to reduce that significantly by various measures: cost reduction, delayering, simplifying the organizations and relying on more outsourcing for this part of our cost. So that are the two examples that I wanted to share with you.

Very quickly [slide 35], and that is my second point, despite the fact that we are perfectly on track on Perform 2020 as we designed it at the beginning of 2015, the context and the market environment is tougher than expected, with the evolution of the unit revenue and the impact on our results. You see that, starting in second half of 2014, the unit revenues at Air France-KLM started to fall. I have to say it was the case everywhere. My colleagues from various airlines will probably confirm that trend, that unit revenue have been under pressure. For us, it has immediately triggered a significant turnaround in the track of improvement in our results. So you see that, also starting in second half of 2014, the improvement in our operating result has shifted from the plus to the minus.

So it has led us to implement new measures [slide 36] to accelerate the cost reduction part of Perform 2020 and to amplify this cost reduction program.

We have also in general amplified what we had in the Perform 2020 plan by putting pressure on our capacity. For Q4, we were targeting growth in capacity of 2.3%, we are now targeting +0.3%, so we are even more cautious in terms of capacity increase.

We have implemented various immediate measures on expenses, purchasing. We are targeting EUR80m impact for Air France. They have been announced in June by Frederic Gagey. We are accelerating all our cost savings initiatives and we have fixed a very clear deadline for our unions to conclude negotiations. So for KLM, it is done but they have still to implement the agreement and to relaunch the second phase for the cabin crew on the ground. For Air France, it is ongoing and the target date is September 30 to close the negotiation.

We strongly believe that we are able to conclude agreements with our staff to reduce our cost at a level that allows Air France-KLM to fight, to be on track again on the growth path with significant savings from all the categories of employees, and it is our central scenario. If we do not achieve positive agreements in that regard, we will be obliged on both sides, first in Air France and quickly after in KLM, to significantly reduce our long-haul network.

In terms of outlook for the second half of 2015 [slide 38], as you see, the Perform 2020 program as it was designed, all the initiatives are under deployment and perfectly on track. We were expecting savings on fuel bill, but they have been completely offset by the unit revenue pressure and for those who remember our annual results for 2014, we flagged this point from the beginning. We have been accused of being very cautious, but I have to say that the reality is unfortunately in accordance with what we planned.

For the second-half capacity growth, we have revised our capacity growth down from 1.8% down to 0.9%, so we are still very cautious and very strict in terms of capacity discipline. Our financial targets are totally unchanged: we target a range of 1% to 1.3% in cost reduction, first of all, of course at constant currency, fuel price and pension (that's as usual), and our debt target is unchanged at EUR4.4b at the end of 2015. Pierre-Francois has already commented that point in detail.

So as a conclusion [slide 39], I would like to say that the growth part of Perform 2020 is on track and successful, in terms of product and services, in terms of growing Transavia and maintenance. We maintain a strict capacity discipline and a very strict investment discipline, and it has produced the significant improvement in terms of cash generation that Pierre-Francois has commented on.

We have a very precise and clear timeline and schedule for our social negotiations on both sides, in KLM and in Air France, and a clear alternative. We target a successful negotiation; if it's not successful, which is our main target, we will have to reduce our long-haul network.

We have accelerated our cost initiatives due to the revenue pressure and to the strong competition we are facing. For those who are reading some newspapers, you have probably noted that we are also looking for the support of other stakeholders, our governments, the EU, to lift some heavy charges that we have on our shoulders, to reduce some costs and taxes, such as airport charges or over-flight fees, and to help and to launch a negotiation round with some states external to the EU in order to balance what is sometimes considered as unfair competition.

Thank you very much for your attention and we will be very happy to answer your questions.

QUESTIONS AND ANSWERS

Forward bookings

Q1) (Yan Derocles – Oddo) The first one on forward bookings, because with this very good performance in terms of advanced ticket sales, could you give us maybe some color on July and August and if possible, the breakdown by network?

Alexandre de Juniac: Okay, on forward bookings, first of all, I would like to stress that in the current environment, which is heavily impacted by currencies, by the fuel price and by the growth rate everywhere in the world, it is very difficult to draw clear conclusions on unit revenues from bookings. So, first of all, be cautious. Everywhere in this industry, for those who are participating in the IATA meeting, you have probably questioned my colleagues, everyone is very, very worried about the lack of visibility in terms of unit revenues and the lack of correlation between bookings and unit revenues, due to the phenomenal impact of foreign currency and the fuel price. That has really completely shaken our forecast models. We are not alone to say that, as you know. But just to give you a glimpse on what is happening on bookings, booking for July and August are positively oriented. But no definite conclusion. Please, be cautious.

Status of labor negotiations at Air France

Q2) And the second one on Perform, because you said you are on track on Perform, but I have not seen huge progress on Perform on the Air France side, so could you elaborate a bit on the negotiations with the unions?

Alexandre de Juniac: Second point, on Air France and the progress of Perform. Perform has been implemented at Air France and KLM differently in terms of schedule. You'll remember that KLM started negotiations in December 2014, because their agreements were ending at the end of 2014 and it took six months, at the end, to conclude the three negotiations with the cabin crew, ground staff and pilots, which was what we had in mind and exactly the deadline that Pieter Elbers had fixed with his unions.

Frederic Gagey has launched his negotiations with Air France at the beginning of May, as planned. You remember that we had elections in April and so we couldn't negotiate with the teams who were finishing their mandates, because they could not commit. So Air France started at the beginning of May its negotiations and Frederic Gagey has fixed a deadline of the end of September to conclude the negotiations. If you look at your papers, you will see that, at the beginning of the year, we said that the negotiations should be concluded in October and so we are exactly on track. We are not used to commit on something and not to hold to our commitments.

Status of relationship with Etihad, Alitalia

Q3) And maybe the last one on Etihad, could you update us on the current status on your discussion with the Etihad both regarding Alitalia and the further development of your relation with Etihad on the Middle East and on the Asian network.

Alexandre de Juniac: As you know, we have three very strong links with Alitalia: one in Europe, one in maintenance and one on the North Atlantic. All these agreements are still valid and ongoing and we are discussing with Alitalia how we can maintain them, for mutual benefits. I stress it is for mutual benefits, for them and for us, particularly the European agreements that they want to renegotiate. So we are discussing with Alitalia to maintain these relationships at the high level we have them.

With Etihad, discussions are ongoing in terms of collaboration in the passenger business. I take advantage of your question to kill definitely what I saw in a press article coming from another country in Europe, that we are in discussion for a participation of Etihad in the capital of Air France-KLM. It is not true at all. No reality on that point. Discussions are on the traditional cooperation in the passenger business.

Cargo situation

Q4) (unidentified) Could you update us on trends in cargo in terms of volume and pricing?

Pierre-François Riolacci: As I mentioned, we had a tough moment in cargo, I think with basically different trends. The first one is that, as I mentioned, the pickup in demand in Europe that we had at the very end of last year, beginning of this year, has gone. So definitely weak demand. We still have a lot of capacity coming in with full freighters coming from the Gulf carriers but also the Chinese carriers. And three, the pressure on the price, which is led also by the decrease in fuel surcharge which are passed on to the market including by the players who are unhedged. So definitely, the unit revenue developments that we've seen during the first half from cargo are disappointing. While in the passenger business, we are broadly in line with our expectation, in cargo, we are definitely below what we had in mind for the year.

We expect some recovery in the second half of the year, which is mainly based on the restructuring of the network that we've been carrying on. If you look at what we have in mind, we decrease further the full-freighter capacity during the second half, so we are playing with the network to make sure that we shift our capacity to the best use. So we expect the unit revenue not to improve, but to deteriorate less during the second half of the year than in the first half.

I would like to mention then when you go for restructuring in cargo, it works. And when you look at the full-freighter operations that we have today at Charles de Gaulle, they are basically at zero operating income. So we break even, we can break even in the full-freighter operation as long as we go with the tough restructuring, decreasing cost and also shifting the network. So that's what we have been doing at Charles de Gaulle. That's what we are doing today at Schiphol, and we are looking heavily into that.

It's fair to say also that we need to work further on costs. We also need to work on the revenues. I mentioned the yields. The load factor were poor during the first half of the year. We have changed a bit our policy to make sure that we fill reasonably the aircraft, which is being done since May and it shows already some improvement on the load factor. So we believe that the second half should be less negative than what we've seen during the first half. The top priority for us is to execute the restructuring that we still have in Schiphol. It will be at the end of the year that we'll start to see some of the impact.

Transavia France network adaptation

Q5) (Eric Blain, tradition securities) First off about Transavia. You said that you have to reorganize your network because of problem in North Africa and perhaps a little about Greece. The effect of this reorganization should be quite negative on the third quarter, or is it already done?

Pierre-François Riolacci: On Transavia, we have already started to change the capacity. One of the great things to be in this business is that you can really adapt the network in a much more nimble way, than what you can do on the full carriers. So we have already started to decrease our operation in North Africa and for example we move to a new route Orly-Amsterdam, we launch Lyon to Algiers and we can really play with the network much more aggressively that we can do usually.

Also I would like to mention that even if North Africa is hit, the yield that we achieve in North Africa are still very good. So we are not going to cut North Africa, because we have VFR (Visiting Friends and Relatives) in North Africa, which is a very good market. So it's still there. It's just that, if you look at Tunis,

it's still there and if you look at some other destination, some other routes, it's not there. So yes, we have to change the network. Is it going to hurt a lot the third quarter? No, I think especially the third quarter is also a very important point, July and August and especially August are very important months for Transavia, which is a very seasonal business. We do not see a major hit during the third quarter on that part, but we will carry on refocusing the network. It is not exactly what we planned, and we missed an opportunity with North Africa. We are not telling you that it's good, but it won't be a disaster. It's just that we need to change routes and that's what we are doing.

Margins in maintenance

Q6) And my next question is about the maintenance business which is perhaps with a better visibility. Can you give us some idea about the impact on the profit margin, of the growth first, and of the change in currency please?

Pierre-François Riolacci: On E&M, you need to be careful when you look at the quarter's numbers, you know that it's a business which recognizes revenue based on milestones for a large part of it. So you can have a very important shift in margins. I think, if you look at the underlying trends, the first one is that organic growth is strong, and organic growth is not at all dilutive on margins. We do not enter contracts that would be dilutive on margins. There is no risk about that. There are always risks attached to a contact, but I can tell you that we are not growing detrimentally to margins, that's not what we are doing.

It's true that we have a push on margins which is linked to the fact that we have 30% of our cost in euros. This is not unknown to our customers and we have already customers turning back to us and saying: hey guys, you're going for windfall profit, please give me part of it. So we will not maintain this profit for 10 years, but we benefit at this from a lagging effect for a while, and it gives us a very strong position in terms of negotiation with our customers. That's indeed a rather good news, so you can expect margins would be well oriented.

Again, I stress that this quarter was very strong. You may remember that the first half last year was not a big one for E&M and we made a much better second half, so you have a basis effect, so please do not factor in such a massive improvement that you have in the quarter into the full year. However, it's clear that it is a business which is doing very well today.

Unit cost dynamics in second half

Q7) (Monique Pollard, Goldman Sachs) You have a unit cost reduction in the quarter of 0.5%, while maintaining the unit cost reduction target of 1 to 1.3% for the full year. Where is it coming from?

Pierre-François Riolacci: I understand that your question is related to the fact that we have a unit cost reduction in the quarter of minus 0.5%, but we still maintain the target of minus 1% to 1.3% for the full year, and where is it coming from. I think that we made already during the first quarter release, that we expected the unit cost improvement to occur mainly in the second half of the year. And this is on the back of two things, the first one is that we have some cost measures and mainly it is the leaves of the Air France VDP, so you will have the full impact on the second half when you had only part in the second quarter.

And we have a second key item, which is that our capacity growth is focused on the third quarter so will have beneficial effects on unit costs given the increase in our capacity with a lower increase in cost. So we have good reason to believe that the unit cost variation will improve through the quarters up to year end. You remember that during the first quarter we had basically no unit cost reduction, it was minus 0%, minus 0.5% during second quarter, we expect a much better in Q3. There are also some urgency measures added by the two airlines and they've been announced a few weeks ago. That will also help to secure this target, which is obviously, and you're right to point it out, more challenging since we have

decreased our capacity expectation. We have slowed down our capacity significantly, especially in the fourth quarter, so of course, it's putting pressure on our target. So basically, given that we have with the restructuring, given the increase of capacity in Q3 and given the urgency measures that both KLM and Air France have announced, we believe we can make it with a strong acceleration in H2.

Extension of Transavia outside of France and the Netherlands

Q8) (Oliver Sleath, Barclays capital) My first question is regarding Transavia Europe where you mentioned you're re-launching discussions with the pilots. That was obviously a major sticking point with the unions during the strike. Do you feel you're now getting better engagement with the pilots? And if you were to re-launch that initiative for Transavia moving outside of its home market, will that be included within your current growth plans for Transavia to get 16m passengers by 2017 and 65 aircraft or would you be looking to accelerate that growth rate?

Alexandre de Juniac: On Transavia Europe, clearly, first of all, on the Dutch side, we have had an agreement with the Dutch pilots in Transavia to reduce cost in Transavia, but also in the discussion we have with the Dutch pilots to see how we can develop Transavia outside of the Dutch borders. For the French pilots, you have probably noted that, publicly, the head of the SNPL said that he was ready to discuss the development of Transavia outside of the French borders. So we have said that we are ready with both organizations, both pilot organizations, but also other unions that are involved, to open this discussion related to the development of Transavia outside French and Dutch borders. We are ready. It will be done and we are targeting an implementation by summer 2016 of this growth path.

Secondly, in the figures I gave in terms of millions of passengers in 2017, of number of aircraft, this growth outside France and Netherland is not included. So it will come on top of the figures I gave to you previously about Transavia.

Deterioration of North Atlantic unit revenue trend in Q2 vs Q1

Q9) Second question on the North Atlantic, I appreciate it's a good market for you and you benefit from US dollar and fuel, but the pricing performance there has still dropped by about 5% compared to Q1 from plus 2% to minus 3%, with not much capacity growth. I wondered if there is any reason for that deterioration and in particular, how is the relationship with Delta, given they're focused on growing their own joint venture with Virgin out of London this year across the Atlantic.

Pierre-François Riolacci: Thank you for giving me the opportunity to elaborate a bit on North Atlantic. I think that it's very much that you get the vision that the North Atlantic, actually the unit revenue has not deteriorated during the second quarter. If you look at the unit revenue in nominal terms, it is actually increasing and increasing significantly during the second quarter in line with Q1. So we have a plus 6% unit revenue development actually in the second quarter on North America.

And if you look overall at the unit revenue development in the second quarter, in nominal terms it's still positive. So you have a massive impact on the Forex, so when you look at the economics of the joint venture of the transatlantic, from outside you need to take in account the real actual currency conversion between US dollar and euros. So it's definitely a great boost. And that's the reason why we can accept to have a lower yields excluding rox, but when you get them back in euros, actually it's very strong. So today, we do not have actually an issue with North America. It's definitely doing good with obviously a shift of value from Europe to the US which is linked to the currency. That's why when you look at the numbers excluding rox, you need to be very careful and factor in the currency impact. So unit revenue on North America is not deteriorating in nominal terms, on the contrary, it is improving.

Expectations on government lobbying initiatives

Q10) (Andrew Lobbenberg, HSBC) Can you tell me whether you see any risk for your plans to lobby governments and the EU given the decision of several companies to leave the AEA and a lack of alignment on attitudes towards the Gulf issue?

Alexandre de Juniac: So on the lobbying issues, we have three sets of issues. First of all, with our respective national government, the French and the Dutch government, we are asking our two governments to help us in terms of lifting some charges, reducing airport charges, overflight fees, some taxes. And we have specific lobbying plans with each government on these issues. We have a reasonable expectation in terms of government reaction to help us, especially in giving arbitration between Aéroports de Paris and Air France or in helping us to discuss with Schiphol or with the civil aviation. So it is working, and normally with a reasonable timeframe.

We have a second set of issues, which is with Europe and that we are pushing with four of our colleagues, namely Lufthansa, British Airways, Ryanair and easyJet. We are pushing Europe to lower costs everywhere in Europe and to improve the competitiveness of the European sky, which is among the most expensive on the planet. So we are pushing hard. It will take time. The timeframe will be probably longer than for the national timeframe. But we are pushing hard. And we expect a new aviation package by the end of this year.

And we have a third issue that we are pushing mainly with Lufthansa and some Nordic country airlines, which is to open negotiations with the Gulf States to balance the competition conditions. We are pushing hard to open negotiation, to give a mandate to the European Union to negotiate with the Gulf States about aviation and to have fair competition conditions. We are also pushing for a litigation management system for aviation, which does not exist currently, which would be similar to what is in place inside the WTO framework. These are the three sets of issues we are pushing.

Media and political environment in the Netherlands

Q11) And my second question would relate to your attempt on cash pooling with KLM. Has there been any progress in normalizing the media and political environment in Holland to allow this normal corporate process to take place?

Pierre-François Riolacci: This cash pooling issue was very emotional, so we know that emotions can be both in the North and in the South. So when it's emotional, you'd better try to find a pragmatic way. I think that we've done good progress. You've seen that we've been able to manage, one, the issue of the hybrid, which is a subordinated bond at the level of the holding. Two, we've been able to renegotiate and renew the credit facilities both in France and in Netherlands successfully. So it's done. I think that we've found what I would call a workable scheme. I would have preferred an optimal way, but we work -- we define a workable scheme.

It's not the end of it because we are also working on different ideas, not about cash pooling. I think it's definitely not on the agenda. But we are working on a good way to get KLM accessing financing at Group level and tapping the capital markets through the holding. I think that's very important that the reason why holding wants to tap the capital market, it's to [online] the proceeds to the alliance. And today we are working on different schemes that will help Air France-KLM to tap the market in a good manner, and two, to online these proceeds to KLM. I think that we are working pragmatically. And I'm confident that we can find something which is quite workable and beneficial to all parties.

Transavia outside France and the Netherlands

Q12) (Andrew Light, Citi) First of all, can you give a vision of the size of Transavia Europe outside of France and Holland?

Alexandre de Juniac: On Transavia outside France and the Netherlands, we are targeting some aircraft for 2016 and the doubling of this number of aircraft in 2017. Let's say something which would be slightly less than 10 aircraft outside of France and Netherlands.

Details of alternative plan in case of failure of negotiations with Air France unions

Q13) (Andrew Light, Citi) Can you quantify the extent of potential long-haul network reduction if you don't reach agreement with the Air France pilots union? And how many aircraft deferrals are we talking about? And also why cut long haul when I thought that was the most profitable part of the business?

Alexandre de Juniac: For the potential downsizing in case we do not achieve successful negotiation, Again, this is not our central scenario, we are targeting to successfully negotiate with our employees. It would be a significant reduction. It's still under work and we are studying that. We will disclose it in due time, and first of all with our people before disclosing that openly outside. Sorry not to give you more answers.

Pierre-François Riolacci: I think it's clear that we don't want to go into any blackmail. And I think that's very important that it's not our position. But you know that at Air France, we have a significant share of our long-haul routes which are losing money. And this needs to be addressed. And there is a good way to address it, which is to improve the competitiveness of our own cost. It's normal that you have a certain amount of routes which are loss-making because they also participate to the network and the global footprint. However, today's level is unsustainable. So of course, if we cannot improve our costs, our competitiveness, then we have at least some routes which are beyond rescue that will have to be challenged and probably closed. That's where we are. And the magnitude, it's too early to say because it depends of what will be achieved.

Split of operating losses between Air France and KLM

Q14) Of the operating loss for the first half, are you able to break it down between Air France and KLM?

Pierre-François Riolacci: There is a slide in the appendix. If you look at page 47 of the appendix, you will see that basically the EBITDA margin of Air France and KLM in the second quarter are actually very close. And you know that Air France still benefits from a strong momentum from Transform 2015. KLM is just re-launching its cost initiatives. Therefore there is definitely an improvement in Air France.

Also you need to remember that the pension adjustment that I mentioned, which is for the full year EUR120m, is hitting EBITDA and EBIT at KLM level. There is no cash impact. But there is a big impact on EBITDA and EBIT. And the margins are actually equalizing over the second quarter.

We do not comment on operating profit. We do not comment on operating profit at Company level. But you can imagine that it's now getting very close during the quarter between the two airlines.

Details of alternative plan in case of failure of negotiations with Air France unions: fleet impact

Q15) (Damian Brewer, RBC) If I could ask about the long-haul fleet position, in particular you mentioned potential if you don't reach agreement for a significant reduction. Would that reduction focus on just one fleet type potential or I see there's been some contingency planning there already?

Alexandre de Juniac: Do we change the composition of the fleet? Yes, the change we have in our fleet plan is to replace our old aircraft, namely the B747s and the A340s for Air France and the B747s for KLM by new aircraft, B787s and A350s. So it is normal replacement and upgrade of our fleet by more fuel saving aircraft compared to the old ones. There are no significant changes in the fleet except those I am mentioning.

Fleet allocation per region

Q16) In terms of the shape of the long-haul business going forward, very noticeable that your long-haul premium business in North America is doing better than average. Will that influence the shape and mix of where you allocate future capacity or indeed how you might allocate what you've already got?

Alexandre de Juniac: To answer the second part of your question, we permanently allocate our aircraft between the various parts of the world. We reduce capacity or frequencies on some countries or some areas in which we are facing difficult conditions, namely, for instance, South America. And we reallocate that to the most profitable part of our network. That is normal business.

The point there is that we have to be cautious again. And if you remember last year, we flagged that the reallocation to North Atlantic was too fast coming from everyone, not from us, by the way. Not from Delta and from us, but coming from the rest of our competitors. We have to be cautious when we reallocate not to put too much capacity on a so-called profitable part of the network, otherwise we destroy the yield. As usual, normal business, but we do that cautiously and in a reasonable manner.

Details of alternative plan in case of failure of negotiations with Air France unions: fleet impact

Q17) Therefore if you do have to shrink the fleet, would that be shrinkage across all aircraft types or ones which you have marked for retirement anyway?

Pierre-François Riolacci: In the discussion of the aircraft type, for sure we will continue to phase out old aircraft which are not competitive anymore and you can think about the B747s and the A340s, that will be in the next few years phased out. It is clear that pressure that we have on some part of the network create opportunity to phase out this aircraft a bit quicker than normally expected, that's part of it. Now, the key question is: what will be the pace of phasing in the new aircraft, which are the B787s and the A350s? That's the question and this question is very much reliant upon what is happening in terms of competitiveness. It is clear that we are not prepared to phase in new aircraft when competitiveness is not back. It is not a good way to improve your competitiveness investing money and getting new aircraft. So that is exactly the balance we have and that is the start of the discussion. And this point is open.

Alexandre de Juniac: Thank you. If there are no further questions either on the phone or in the room, thank you very much for your attention. And yes, the session is over. Thank you very much again. Thank you.