



# Finnair Q3 2016 Results

Wednesday, 26<sup>th</sup> October 2016

## Welcome

Kati Kaksonen

*IR Officer, Finnair*

Good afternoon, ladies and gentlemen. I am Kati Kaksonen from Finnair IR. It is my pleasure to welcome you to this Finnair Q3 results call and webcast. As usual, our CEO, Pekka Vauramo and our CFO, Pekka Vähähyppä will give a short presentation on the results, and that is followed by Q&A. I would also like to introduce our new Group Treasurer, Christine Rovelli, who is also present here today to take your questions later on. Without further ado, I will give this over to you, Pekka. Go ahead.

## Q3 Results

Pekka Vauramo

*CEO, Finnair*

### Highlights

#### *Market concerns*

Thank you, Kati. I am Pekka Vauramo, CEO of Finnair. We are very happy about the Q3 results: we improved from last year, marginally though, but improvement is always better than the other direction. We are of course seeing pressures in the marketplace, that are well known in this industry. The competition in the Atlantic is very intense at this moment. We have been somewhat on the side-line of this one, because our exposure on Atlantic traffic is not as great as with some of our peers in the industry. We have bigger exposure, as you probably know, in Europe and in Europe to Asia traffic. Nevertheless, that is affecting us.

Then, market concerns, part of that one is also the European security situation, which we are feeling on our side. We do see group cancellations from Asia; we have seen it throughout the year, and the situation is still more or less unchanged. Of course, we hope that we do not see any more further incidents in Europe, but of course there are no guarantees for that one at all. On the contrary, we are also seeing more interest in other areas of Europe other than Central Europe and the Southern Europe. We are seeing more interest on Nordics including Finland; we are seeing more interest on Iceland, and we are opening a flight next summer to Iceland, to Reykjavik from Helsinki; and some increased interest on Baltics and Eastern Europe. So, Asians are avoiding Central Europe and Southern Europe, but are looking for other areas and regions of Europe.

#### *Growth strategy actions*

We continue to implement our growth strategy, and there are several actions that we have taken for that one. We took a delivery of our seventh Airbus A350 a few weeks ago, and we are very happy about the aircraft and its performance. Its despatch reliability is improving all the time, and we are getting closer to the level of our existing fleet. There are still some training issues that we have with the aircraft, some spare parts availability issue and things like that, and we are still not quite on the same level as we are with older aircraft, but we will reach those levels soon.

We were happy about the Fukuoka opening for this summer, and the other long-haul route that we opened was Guangzhou, and that was somewhat weaker. I think Guangzhou also suffered from the issues in Europe, while our Japanese flights were not affected as much as the Chinese flights for that.

For next summer, we have announced already that we will open San Francisco, and we add frequencies to Tokyo and Hong Kong. San Francisco has been a good start; we announced it only a few weeks ago for next summer, and sales have started at a really good rate. These added frequencies to Tokyo and Hong Kong mean that we will fly next summer 35 weekly flights to Japan and 35 weekly flights to China, so we are growing as our strategy is to grow, and we will see that in increased flights.

#### *Digitalisation*

In the digitalisation, we are taking steps to make communication and purchase of tickets and services from us easier. With our mobile app, we received a Red Dot Award, and the active user number is increasing all the time; likewise, is the popularity of Finnair.com increasing fairly rapidly.

#### **Market position**

##### *Added capacity*

Moving on to page 3 now: we added capacity altogether for the ASKs by 8.4%, and most of that came from our long-haul operations. We were able to gain market share in European and Asian traffic, and now we are changing the trend, especially in Asia since we have been losing market share because we have not added capacity. Now we are adding capacity and we are gaining market share, and we intend to keep it that way despite all the issues in Europe currently.

##### *Travel demand*

We see that travel demand continues to grow in our main markets, and especially we have seen the growth in Nordic destinations. The Siberian Joint Business serving the Japanese routes are performing well; a stronger Japanese Yen is contributing nicely to the success of those routes and that co-operation, while the Atlantic Joint Business altogether is suffering somewhat from the challenging market environment. As we are part of it, we are also feeling the pain there, and we are also having some issues with the load factors currently on our Atlantic routes. However, we feel that they have been the right decisions to take, and we will start improving load factors in future from those levels where we are today. We will look at them a bit later on.

##### *Cargo market*

In the cargo market the situation has remained sluggish, as it has been for quite some time now. In the yields, we see the downward trend, but we have been able successfully to grow the volume and we are now fairly close to bottoming out the cargo turnover development. The latest month that I have seen on cargo shows that we have already started to grow the cargo turnover, and that is of course a good result and an important point for us. That might be boosted somewhat by the Hanjin Shipping Company bankruptcy, but nevertheless we are seeing increased volumes and increased sales of cargo business as well.

### *Aurinkomatkat*

Our package tour business, Aurinkomatkat or Suntours, continued to grow and grow the passenger numbers, and good development continues in their operations.

### **Improved comparable operating result in an increasingly difficult market**

#### *Revenue growth*

Moving on to page 4 now. Our revenues grew 3% to €641 million; of course, compared to the capacity growth, this is not quite as what we want that to be. However, we had several route openings and it is very typical that they start with fairly weak sales and fairly weak load factors, and this is for us to improve in future. Ancillary sales continue to grow, and our aim is to keep that one growing at about 15–20% per pax, and maybe above 20% in total. We are now in our ancillary sales at about €150 million level in total, and that starts to be an interesting and important part of our business in total.

#### *EBIT growth*

Our comparable EBIT result improved by 2.3% to €65.7 million, which is almost €2 million better than last year. Last year, we said that we made a record result, so this is also a record quarterly result that we make now, and it is an eighth consecutive improvement that we have shown in our EBIT development.

### **Growth in passenger traffic revenue**

No big surprises in the revenue categories. There is a big negative on travel agencies, and that relates to the divestment of Estravel in 2015, and even remaining part of the SMT, the travel agency group that we have, which we have announced that we have agreed to sell. That will most likely close within a few days, and then the travel agencies are gone from the Finnair Group from that point onwards. Passenger revenue grew by 2.3%, ancillaries by 22% and travel services, which refers basically to basically Aurinkomatkat (Suntours), almost 10%. In cargo, there was a slight decline of 1%.

### **Growth in long-haul traffic**

Then on page 6, the volumes: we have added a lot of capacity to North Atlantic, and we have added the Asia: 12.6% Asia and 22% in North Atlantic, those are the major differences that we see on the graph. If you look at the load factor, I commented that we are not quite happy about some of these load factors. The Asia load factor reduction was 3.3%, and 7.1% in North Atlantic, and these are areas that we need to improve when we move on. However, they can be explained with the new route openings, and especially because the routes that we opened were not that mature. Next summer, if you recall, I said that we will open Tokyo and Hong Kong, and we are much more confident that we will get better starts for those additional frequencies than with completely new routes.

### **Preparation of €20 million efficiency programme is progressing**

Then moving on to page 7: we announced the €20 million efficiency improvement programme after our first half year this year. This programme is proceeding: we have identified more than €10 million of improvement targets that we are currently working on, and the work continues; we aim to finish off this work by the end of the first half next year.

**Growth preparations increase costs**

Then our growth, which is of course causing us costs; currently at this moment, we are estimating that our preparation for the growth means that we are carrying currently about €20–25 million of annual costs. These are for the fact that we are recruiting new pilots, we are training existing pilots, we have a fleet transitioning going on from A340 to A350. We have ten or so of pilots currently that are going through training, and these pilots, while they are training, they are most of the time away from normal flying. Also, there are those new pilots that are still going training, so we really do not get the capacity from them yet at this moment. So, we do have extra cost in the system, and that is of course then affecting our bottom line. We have also had some cancellations because of shortage of pilots, and these are of course unfortunate things and we try to do our utmost to avoid that kind of situation.

We also have wet leases in our system; we have currently three wet leases on our narrow-body side, and we just communicated that we will have one additional wet lease in the wide-body side, on our New York route, in November/December. Also, we communicated that in order to make room for a pilot training, we temporarily cancelled our Chongqing flight from January next year to April, for three to four months. We feel that with these actions we are in balance with the training needs, and we will do the least damage to our traffic programme and our revenue line.

Pilot resourcing remains critical for us; we have several training pipelines available. We introduced a new multi-pilot licence training, together with the Finnish training organisation, called MPL. This was announced just two weeks ago, and we have received 2,000 contacts from potential new pilots after the announcement. So, it is very promising, but we will get some tens of pilots that we target in the first place through that.

*Growth in the longer term*

When we look at growth in the longer term, and our aim is to keep this company growing now that we started to grow finally, we have to have more flexibility with our personnel and have additional means and ways how we can open these growth bottlenecks in order to make the growth successful. We are in discussions with our personnel about this, and are proceeding in good co-operation.

**Outlook for 2016**

Our outlook for the profit remains the same as we have said before, but we are cautious about how the markets are behaving. We have seen an increase in the fuel price, and of course for any increase in the fuel price for the unhedged part of our fuel consumption, we will see a cost increase in Q4; and going forward, of course, depending on what the development then is and looks like. Then we have concerns in the marketplace: we have the European situation, we have the pressure that possibly comes from the Atlantic to other markets, and therefore we see that the markets are increasingly challenging for the rest of the year. However, despite this we will turn out this year a better result than we did last year, and I think we are nicely ahead of it at this moment as well.

That closes my part, and I will hand this over to our CFO, Pekka Vähähyppä.

## Financials

Pekka Vähähyppä

*CFO, Finnair*

### Q3 financial summary

Thank you, good afternoon. I think the CEO has already explained the main message for Q3: we continue to increase our profit. However, I will walk through some of the details with the following couple of slides. So, for Q3 we continue to grow our number of passengers as well as ASK; the number of ASK was even faster than the year to date, at 8.4%. The number of flights went down somewhat, and the reason for that is mainly because we were forced to cancel predominantly domestic flying due to some challenges with the number of pilots and number of cabin personnel, which was also explained by Mr Vauramo. Load factor went somewhat down for the quarter, and that is explained due to the increased long-haul flying in Asian and Atlantic regions. Revenue grew 3%, that is some €20 million, and our comparable EBIT grew up to €66 million from previous year's €64 million, so we are very happy about that we continue to grow.

### Passenger revenue development

If we move on, the next slide is just figures, so we will go further to slide number 13. Here we go through the passenger revenue development, the bridge from last year's €505 million to this year's €515 million. The number of ASK, the capacity amount, contributed to almost €40 million, so contributed to that growth. We had some headwind in FOREX: British pound, and also specifically Chinese yuan were against us for the quarter. That explains €5 million. The impact of lower load factor was almost €10 million, and then some other yield and mix changes contributed negatively, so all in all we ended up with €516 million.

The other way to look at this passenger revenue is by traffic area. We see on the right-hand bottom of the page that the capacity in Asian and North Atlantic destinations grew a lot, but the revenue has not yet grown accordingly. European capacity grew 3% and European revenue grew nicely, i.e. we see the traffic from Asia and from North Atlantic continue to increase the traffic in European destinations. Revenue from domestic traffic declined somewhat, mainly due to the cancellations as discussed earlier.

### RASK declined by 4.9% driven by large capacity increase in long haul

Moving on to the next page, number 14. The consolidated unit revenue declined by 4.9%; that is very much driven by the sizeable capacity increase in long-haul destinations. On the left-hand side of the chart, you can see that the Far East and Atlantic component of the RASK declined both by 5% and 10%, but the domestic and European unit revenue on the other hand grew, which we are very happy about.

So, all in all, if we include all other components of our consolidated revenue – ancillary, cargo – the consolidated RASK declined by 4.9%.

### CASK declined by 4.8%

Moving on to unit costs: they declined by 4.8%, and there are some elements which I would like to highlight here. The purchase and maintenance component grew, and that is pretty much related to the maintenance costs due to A340 redelivery costs. Of course, we are returning these A340s to Airbus when we get these new A340s, so the timing on that is there.

Fuel continued to decline; that contributed positively, the decline was 22%. The expenses of tour operators grew 13% unit-wise; that is explained, first of all, by the overall total amount of Suntours customers growing, and also the Suntours allocating its capacity from Turkey to Spain and Italy, which cost-wise are more expensive than Turkey, for example. So, this is an allocation type of development, but as Mr Vauramo earlier said, all in all Suntours development was very positive.

So, total CASK declined by 4.8%, but if we look at CASK ex fuel, that grew by 2%. When we look at our costs, I think it is good to keep in mind that we have these investments or costs which are growth-related. We have personnel in training and we pay their salary, so that is good to keep in mind and remember when looking at our CASK unit cost development.

### **Comparable EBIT**

Moving on to the comparable EBIT picture. As I said, we had €64 million EBIT 2015; that was an all-time high, and now we are able to beat that with €66 million EBIT. That is caused by growth; our total revenue grew by roughly €20 million. Staff costs increased by €9 million, and I would say predominantly that growth comes from our flying personnel. On fuel costs, the fuel bill declined by €25 million; looking at that, and keeping in mind what Mr Vauramo said earlier, we do not anticipate a big positive development in the fuel cost for the next quarter due to the price increases. I think the other lines in other cost components are pretty much volume-related and I have already commented, so we can move on. The biggest cost component in total euros declined some €24–25 million from €153 million to €129 million, but that is still the largest cost line in our P&L compared to revenue.

### **Strong cash flow and cash funds**

Moving on to cash flow: we had a very strong cash flow during the quarter. Our operating cash flow was €190 million; the biggest contributor to that was EBITDA, €180 million. We did invest a lot, so net investments were €234 million; we invested in three A350s, and then did some other investments as well. We did dispose some assets, that is A340s and some other assets, worth €150 million.

When looking at financing, we have financed with JOLCOs – the Japanese operating leases with call options – three of our A350s, and that has shown as an increase in debt. On the other hand, we repaid in advance all our bank loans during the quarter. So currently, when we look at our debt portfolio we have a €160 million bond outstanding and the other debt is JOLCO financing. All in all, our cash funds including investments in the maturities of no more than three months totalled €874 million.

### **Balance sheet**

Looking at the balance sheet, it is natural that our balance sheet, the total amount of equity and liabilities, is growing due to this aircraft investment. Now it is almost €2.5 billion. Our equity ratio is solid at almost 34%, and adjusted gearing is also very solid at 68%.

### **Net confirmed capital commitments €457 million**

If we move on the last slide, we do need a strong balance sheet so that we can finance our ongoing investment programme. For the following three years, we have net confirmed capital

commitment of €457 million, which is mostly related to our ongoing A350 deployment programme.

With these words, I will end my part and give a word to Kati.

**Kati Kaksonen:** Thank you, Pekka and Pekka. Now we have time for your questions with the Q&A.

## Q&A

**Andrew Lobbenberg (HSBC):** Morning guys, girls. I wonder if I could start with the extra cost that we are getting for the wet lease and the crew training: you said €20–25 million, when does that hit us? Is that all in Q4, or is it spread over the two years?

**Pekka Vauramo:** It is an annual course that we currently have; we are expecting that there will be an additional cost that we have to carry for the next 18 months, and then we should be over this training and transitioning fully. However, that is an annual cost increase that we have in the system, because of the growth. Then it will be absorbed into the operations.

**Pekka Vähähyppä:** This is Pekka Vähähyppä: we can say that three quarters of that annual cost is in this year's result already.

**Andrew Lobbenberg:** Okay, yeah. Also, just to understand the fact that we do need the wet lease and to pull Chongqing; I mean, are you putting it all down to the late deliveries of the A350s that have put the challenge on the pilot training, or is it that you are not sourcing the people?

**Pekka Vauramo:** It is both, to be honest; we have not been able to train our personnel during the summer time as efficiently as we thought we would be able to, and therefore we need to now create some room in our flight programme so that we can catch up with the training. We are slightly late with that one, and therefore we need to do some temporary cancellations, therefore we need wet lease.

**Andrew Lobbenberg:** Okay. Then I guess, can we just come back to the Asian trading? I think you mentioned in your remarks that there was no sign of a change in habit, but I am now just trying to understand how badly the demand is suffering from both China and Japan – I think they are a bit different – and what we should expect to see for the winter, and how much, fingers crossed, we need for the summer now.

**Pekka Vauramo:** Yes, we do see cancellations that are much higher than normal in this sort of approved travel that most of our Chinese sales are; we are seeing sort of 15–20% more cancellations than what we have seen in the past. So, it is substantial, but it is nothing that we cannot compensate, provided that we have the right network selections in place, plus we can promote other destinations here in Europe. We have partially succeeded with this with the Nordics, and we have added Reykjavik next summer into our programme and that seems to be selling very well in Asia right now.

The main differences are, by the way, with China and Korea with these cancellations. There are some cancellations from Japan but they are behaving somewhat differently; maybe they are a bit more experienced with Europe in Japan, and can treat Europe as several different regions better than maybe some other places.



**Andrew Lobbenberg:** Okay. Then can we just turn to the Atlantic? It is a dramatic drop in load factor; how are you going to fix it? From looking at the schedules and looking at the behaviour of your competitor airlines, it does not seem that there is any new-found sanity in terms of capacity; every day a new airline is announcing an imaginative route that I had never thought would be flown. So how are you going to fill it, and in particular how are you going to fill San Francisco when that is a market where you do not have any support from Americans?

**Pekka Vauramo:** Yes, we will see how that one takes place. However, I think I mentioned that San Francisco sales have started very nicely, and there is quite a lot of business demand for San Francisco. Of course, we realise that we will not fill the plane with the business travellers; we have to be able to sell to tourists and leisure traffic. However, right now it looks positive from our side, and we will see next summer how that one goes. We had our first summer for Miami this year, and Miami of course is a big-time leisure traffic and leisure destination. There is, of course, some business traffic going that way, and we now need to see whether we can attract that and turn that into more of a business destination as well for us. That will probably give us better yields in the average yields, plus then also improve the loads.

**Andrew Lobbenberg:** In terms of the origination and destination of the traffic you are sticking on the transatlantics: it is presumably substantially to/from Finland, no?

**Pekka Vauramo:** Yes, Finland is of course the main market for that one, but also the Baltics, Nordics in general, and some from Russia. They are the ones. We are seeing some connecting traffic from our Asian flights: India, even some Chinese destinations. However, they are of course small volumes.

**Andrew Lobbenberg:** Yes, okay. Then just finally: on the A350, how far off the fleet average, or long-haul fleet average despatch reliability is it? When do you think it gets to fleet average? How rapidly?

**Pekka Vauramo:** We are approaching the fleet average very rapidly. We were somewhat below the 'global' A350, let's say, which includes all the carriers. We were below that average early in the year, but you have to remember that we were also pushing these new aircraft a lot; we had a fleet of three of them and we had two of them on our Bangkok route, where there is long flight time and daily flight hours were more than 18 hours per aircraft. That is for a new aircraft that is also new to our personnel, and parts stocks are not available; there is no part consumption history. So that was too much, and our reliability dropped during the first quarter. However, we are now in the global average of A350s, and we are not much more than one to two percentage points behind our average reliability, which is a good result for a new aircraft.

**Andrew Lobbenberg:** Just finally, as a last one for me: the new flight by Qatar into Helsinki, are you expecting to be putting a lot of passengers onto that? Do you see that operation threatening your Bangkok trips, or do you see yourselves building towards some kind of joint venture rather than just the co-chair on that?

**Pekka Vauramo:** Of course, we are partners in the oneworld; we do have co-chairs, and there are possibilities to expand the co-chair. We have not discussed joint ventures with them. Of course, everyone who flies here flies here, and especially coming from that

direction and destination, I do not think they will bring too many passengers into our network. They would rather take passengers from our network, so the net impact will be negative for those flows and volumes that they will take from us. However, at this moment they are flying with the A320 and it is not that big.

**Andrew Lobbenberg:** No, okay. Alright, thanks very much, and I will see you guys soon.

**Pekka Vauramo:** Okay, see you, thanks.

**Kati Kaksonen:** Okay, perfect. If there are no further questions, I would like to thank you for joining us today for this call, and have a good day. Thanks, goodbye.

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