"INTERNATIONAL AIRLINES GROUP"

"AIRLIINES"

STUDENT: "ARON CECCARELLI"

COMPANY REPORT

7DECEMBER 2012

Preparing the take off

- International Airlines Group is currently facing a crucial moment of its history since Iberia is going through a deep restructuring plan in order to recover the series of structural problems that led the spanish arm to burn almost 1,7 million of € each day of operations. IAG top management knows this restructuring plan could affect the short-term operations of Iberia but as already happened within the UK business segments, it is the only way to create a solid and strong airline company for the long-term period.

- On day 8 November, the Group has announced the will to launch a cash tender offer for the 54,15%% share capital of Vueling where Iberia already owns the remain 45,85% of it.

- On the British side everything seems easier and straightforward: British Airways, after the Olympic games has came back at the level of 2011 and we forecasts a FY 2012 EBIT of €312 million.

- The high sensitivity of the aviation market to the GDP trend will force us to constantly keep the eyes on the macroeconomic Spanish situation which still challenging even though outlooks for 2013 show small improvements. Good news on the fuel price, it dropped 4% respect 3Q 2011 reaching a price of 110,1$/b while bad new on the Euro, depreciated for 11% against the USD $

Recommendation:	**HOLD**
Vs Previous Recommendation	*BUY*
Price Target FY11:	**2.44 €**
Vs Previous Price Target	*0.00 €*
Price (as of 27-Mar-13)	**2.44€**

Reuters: xxx, Bloomberg: IAG:SM

52-week range (€)	1.678-2.293
Market Cap (€m)	3.914,83
Outstanding Shares (m)	1.855

Source: Bloomberg

Source: Bloomberg

(Values in € millions)	2011	2012E	2013F
Revenues	16.103	18.100	18633
EBITDA	1.877	1.578	2.163
Net Profit	582	-198	239
EPS	0,28	-0,08	0,10
P/E		18,89	
ROIC	4,59%	-0,6%	3,24%
ROCE	3,8%	-0,5%	2,7%
Revenue/Asset	0,8	0,8	0,8
Asset/Equity	3,5	3,9	3,8

Source: Analyst estimation; Bloomberg; 4traders

THIS REPORT WAS PREPARED BY "ARON CECCARELLI", A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS, EXCLUSIVELY FOR ACADEMIC PURPOSES. THIS REPORT WAS SUPERVISED BY ROSÁRIO ANDRÉ WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (SEE DISCLOSURES AND DISCLAIMERS AT END OF DOCUMENT)

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The Airlines Industry

Moving toward consolidation

The high fuel prices and an increasingly competitive environment are driving airlines industry toward a fast consolidation. In fact, the financial crisis has slashed the access to convenient source of capital and a capital intensive business such as airlines forces the firms to look for partners to merge and take advantage from larger economies of scale and synergies. Additionally consolidation is facilitated from other reasons such as the continuous decrease regarding State participations in the companies, fostering privatisation through the entrance of new investors (i.e. TAP,SAS and Air Lingus) and by the gradual deregulation which tends to be greater in the next five years.

Hence, airlines companies are obliged to seek and create synergies with new partners also through membership, alliances and codeshares in order to entry in new markets and so reducing the exposure to single-region risk.

Aviation market has grown 7% each year during the last 10 years (IATA) due to an increase in leisure travel and tourism. Business travelling has increased significantly as well due to the crescent companies' internationalization. As a response of that, airlines carriers have to provide higher quality customer experience and consolidation allows firms to do that integrating "point to point" service with long haul flight amplifying the range of products for customers by controlling costs. Air France-KLM, Latam and IAG are the real witness of this market trend and it is starts to make the difference between the standalone rivals. The possibility to establish an efficiency program of cost-cutting and increase revenues from synergies, the chance to manage the extra-capacity and the opportunity to set it in order to coincide with market demand, are some of the factors that nowadays are crucial to survive in a such competitive environment.

2013: a slight improvement for European carriers

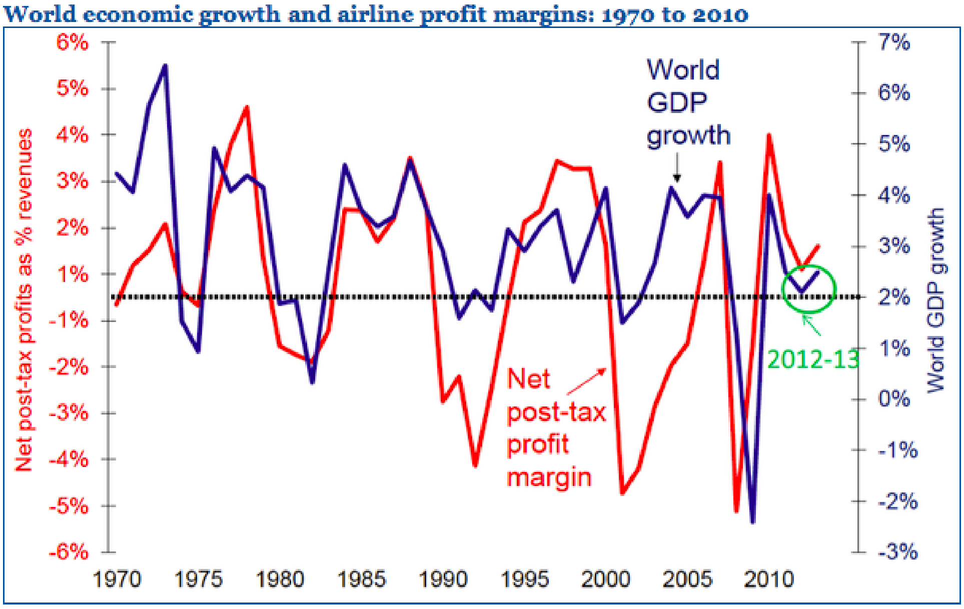
System-wide global commercial airlines	EBIT margin, % revenues					Net profits, $ billion				
	2009	2010	2011	2012F	2013F	2009	2010	2011	2012F	2013F
				Central forecast					Central forecast	
Global	0.4%	4.0%	2.9%	1.6%	2.6%	-4.6	19.2	8.4	4.1	7.5
Regions										
North America	1.2%	4.7%	2.9%	3.0%	3.5%	-2.7	4.1	1.3	1.9	2.9
Europe	-2.2%	1.9%	0.9%	-0.1%	0.5%	-4.3	1.9	0.4	-1.2	-0.2
Asia-Pacific	2.8%	6.0%	5.2%	1.9%	4.1%	2.6	11.4	5.3	2.3	3.1
Middle East	-1.5%	3.6%	3.5%	2.5%	2.7%	-0.6	0.9	1.0	0.7	1.0
Latin America	2.8%	5.0%	2.3%	2.7%	3.5%	0.5	0.9	0.3	0.4	0.7
Africa	-1.2%	1.6%	0.8%	0.7%	0.7%	-0.1	0.1	0.0	0.0	0.0

Source: IATA; ICAO

Asia-Pacific airlines will achieve the best results in 2013

According to IATA forecasts for 2013, European carriers will enjoy a slight around 110$/barrel and the Eurozone crisis. On the other hand Asia-Pacific airlines will be the best performers in 2013 achieving an overall Net Profit of 3,1$ billion.

World economic growth and airline profit margins: 1970 to 2010



Source: IATA

2013: a slight improvement for European carriers

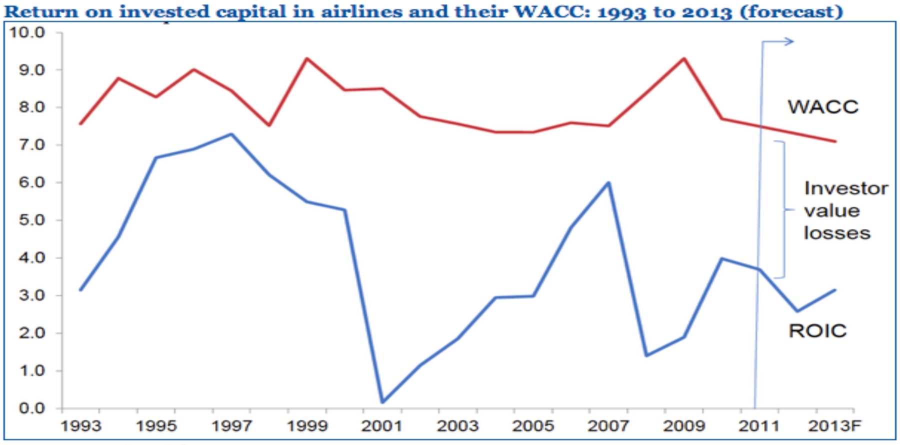
As we can see from the chart, from 1970 until 2010 airlines have reported losses when GDP growth has been below 2%. Fortunatly, in 2013 the world GDP should should move away from this dangerous value reaching an increase of 2,5% although so far carriers have been able to struggle against, delivering good results.

To better understand how much Airlines industry is competitive we should look at the values of Return on invested capital and WACC whereas the first will reach an average of 3%, substantially below the latter which presents a value around 7,2%. In fact, in a similar risky industry, investors are expecting to achieve a return of a least 7,5%(IATA). Last October, the traffic volumes measured in RPK (Revenue-Passenger-Kilometers), have shown in the European market an increase of 5,4% in year to date range compared to YTD 2011 while the available seats measured in ASK (Available-Seats-Kilometers) have shown a rising of 3,3% in the same period of time. Finally, four small standalone European carriers went bankrupt between the end of 2011 and the beginning of 2012, whereas one

Tough times for small standalone carriers

of these is the Spanish carries Spanair that on 28 January 2012 ceased its operations, a strong signal that clearly show the crucial role of the mergers to survive in this industry nowadays.

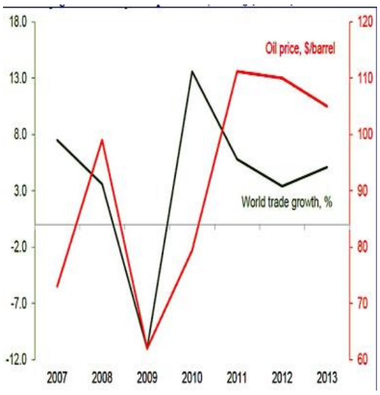
Return on invested capital in airlines and their WACC: 1993 to 2013 (forecast)



Source: IATA Financial Forecast Sep-2012

Continuing looking worldwide, traffic volume forecasts for 2013 measured in tonne kilometres performed (tkp) will achieve an increase of 4,5% while scheduled passengers will jump from 2.973 millions in 2012 to 3.101 always in 2013. The Cargo business finally will return profitable in 2013 with traffic growing at a quite faster pace (+2,4% tkp) after the last two years marked by a negative trend.

Brent oil prices and World trade growth 2013 forecasts



Source: IATA

On the costs side, non-fuel unit costs have been forecasted to present a 0,0% increase in both years 2012 and 2013, showing that airlines operators have learnt to be efficient, keeping expenses under control and exploiting the use of new technologies and the opportunity of economies of scale provided by the higher bargaining power on suppliers due to larger sizes after consolidation. Furthermore, considering the tremendously elevated costs of crude oil, airlines companies are forced to keep an eye on the best costs management practices.

As we just said, oil price is a crucial issue in the airlines industry since it represents almost the 35% of the total operating expenses of each carrier. 2012 together with 2011 have been certainly the years where oil prices have affected most the companies' margins reaching an average of 110$/barrel. On the other hand, due to a new supply from North America and measures taken by OPEC and Saudi Arabia will bring the price of oil down in 2013 to an average of

105$/barrel. Hence, talking about what remains at the end in the hand of the shareholders, IATA forecasts a whole Net Profit for 2013 of approximately 7,5 $billion respect the 4,1 carried out in 2012 even though it represents a margin of only 1,1%.

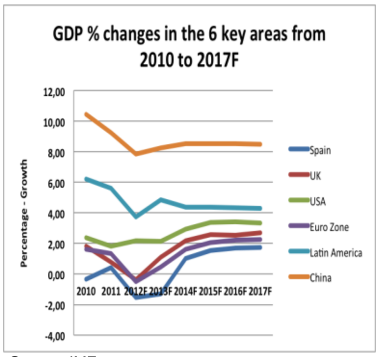
Global commercial airlines traffic and financials 2003-2013F

System-wide global commercial airlines	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012F	2013F
										Central forecast	
REVENUES, $ billion	322	379	413	465	510	570	476	547	597	636	660
% change	5.2	17.7	9.1	12.5	9.6	11.7	-16.5	14.9	9.3	6.4	3.9
Passenger	249	294	323	365	399	444	374	425	468	505	528
Cargo	40	47	48	53	59	63	48	66	69	68	68
Traffic volumes											
Passenger growth, tkp, %	2.3	14.9	7.0	5.0	6.4	1.5	-2.1	7.3	5.9	5.3	4.5
Sched passenger numbers, millions	1,776	1,982	2,123	2,233	2,418	2,485	2,479	2,681	2,830	2,973	3,101
Cargo growth, tkp, %	3.9	7.9	0.4	4.8	4.8	-1.0	-9.8	18.7	-0.7	-0.4	2.4
Freight tonnes, millions	33.5	36.7	37.6	40.0	42.0	41.0	40.7	48.0	47.6	47.3	48.3
World economic growth, %	2.8	4.2	3.4	4.0	3.8	1.7	-2.3	3.9	2.5	2.1	2.5
Passenger yield, %	2.4	2.6	2.7	7.8	2.7	9.5	-14.0	6.1	4.0	2.5	0.0
Cargo yield %	2.0	7.4	2.4	5.9	5.5	7.4	-14.2	15.0	5.5	-2.0	-1.5
EXPENSES, $ billion	323	376	409	450	490	571	474	525	580	626	643
% change	4.0	16.2	8.9	10.1	8.8	16.5	-16.9	10.7	10.6	7.8	2.7
Fuel	44	65	91	117	135	189	125	139	176	208	208
% of expenses	14	17	22	26	28	33	26	26	30	33	32
Crude oil price, Brent, $/b	28.8	38.3	54.5	65.1	73.0	99.0	62.0	79.4	111.2	110.0	105.0
Jet kerosene price, $/b	34.7	49.7	71.0	81.9	90.0	126.7	71.1	91.4	127.5	127.7	122.9
Non-Fuel	279	311	318	333	355	382	349	386	404	418	434
cents per atk (non-fuel unit cost)	38.9	39.5	38.6	38.9	39.3	41.8	39.6	41.6	41.4	41.4	41.4
% change	0.3	1.4	-2.1	0.8	0.8	6.4	-5.2	5.1	-0.5	0.0	0.0
Break-even weight load factor, %	61.1	61.9	62.0	61.2	60.9	63.2	62.3	63.1	63.0	64.1	63.4
Weight load factor achieved, %	60.8	62.5	62.6	63.3	63.4	63.1	62.6	65.7	64.9	65.1	65.1
Passenger load factor achieved, %	71.5	73.4	74.9	76.1	77.7	76.0	76.0	78.4	78.3	79.2	79.3
OPERATING PROFIT, $ billion	-1.4	3.3	4.4	15.0	19.9	-1.1	1.9	21.7	17.0	9.9	17.3
% margin	-0.4	0.9	1.1	3.2	3.9	-0.2	0.4	4.0	2.9	1.6	2.6
NET PROFIT, $ billion	-7.5	-5.6	-4.1	5.0	14.7	-26.1	-4.6	19.2	8.4	4.1	7.5
% margin	-2.3	-1.5	-1.0	1.1	2.9	-4.6	-1.0	3.5	1.4	0.6	1.1

Source: ICAO; IATA

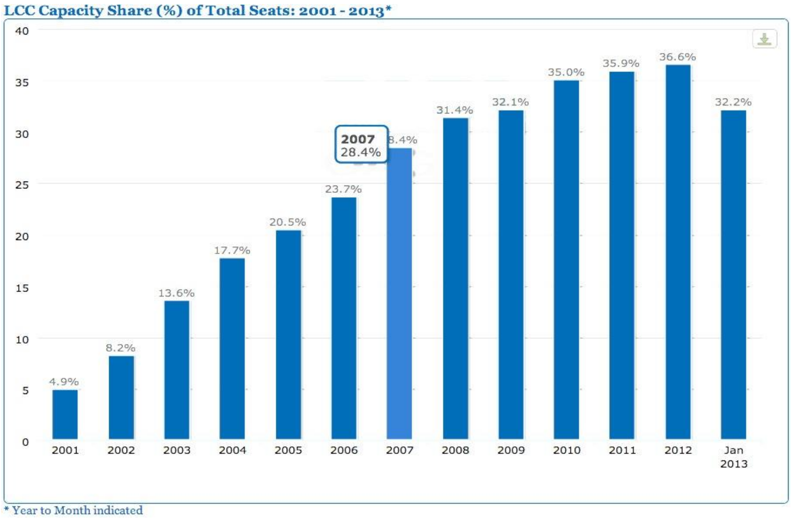
LCCs are still gaining market share in the short-haul market

Real rearing horses of this industry, low-cost carriers (hereinafter called "LCC") are the biggest challenge for the legacy carriers in the short haul market and point-to-point service. In fact, taking off the one piece of checked luggage, eliminating all the meals on board and offering really cheap tickets, LCCs have been able to increase their revenue and gain a huge portion of market share jeopardizing the short haul network of the biggest firm. On the other hand, LCC are more sensitive than legacy carriers to the oil price whereas it can reach the 45% of the entire cost structure. Another theoretical drawback of these kind of operator is the inability to exploit some of the economies of scale that larger airlines can enjoy such as favourable catering contracts but actually this is an issue that does not care too much due to the decision to remove meal and drink on board without additional payments. Regarding the specific competition of Iberia and British Airways with European LCC we well discuss later on during the business segments analysis.



Source: IMF

LCC European Market share in terms of capacity: 2001-2013



Source: CAPA- Centre for aviation and Innovata

Company overview

IAG wholly owned airlines:
British Airways
Iberia
Sun Air of Scandinavia
Iberia Regional (Air Nostrum)
Iberia Express
OpenSkies
BA CityFlyer
BMI

Source: CAPA- Centre for aviation and Innovata

International Consolidated Airlines Group is a holding company, parent of Iberia, British Airways an British Midland International, acquired last April from the German carrier Lufthansa. It is the third biggest airlines group in Europe after Air France-Klm and Lufthansa and the sixth in the world based on revenue. The Group has been created on 21st of January 2011 with the decision to leave the operating companies with their own brands. Currently the fleet includes 398 aircrafts carrying passengers over more than 200 destinations worldwide. Both Iberia and British Airways are members of the Oneworld alliance, the airlines union that provide a high-quality service such as priority boarding, access to First class lounges, priority on waitlists and many other to frequent flyers. Oneworld has been awarded as best world airlines alliance during the World's Travel Awards in 2010. IAG operates from its main hubs such as London Heathrow (British Airways) and Madrid Barajas (Iberia).

On 2011 the group declared its strong interest in the Portuguese flag carrier TAP which could definitely reinforce IAG's market share in a fast growing market such as Brasil whereas the Lusitanian carrier has an indisputable leadership.

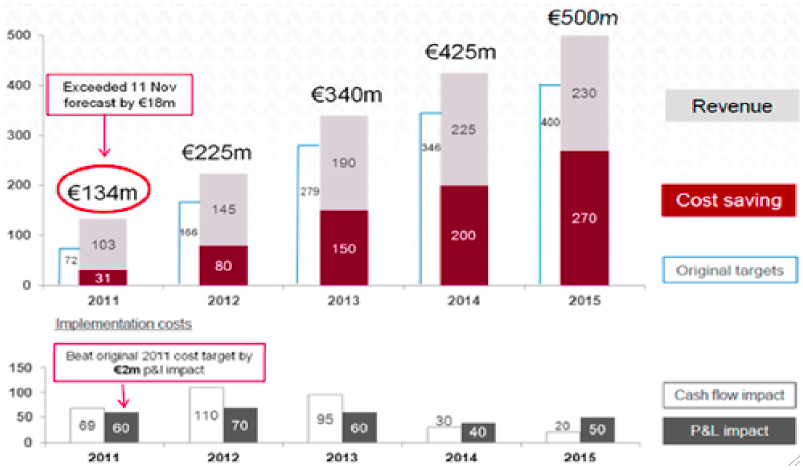
IAG has minority interests in:
Comair (18%)
Flybe (15%)
Vueling Airlines (46%)
Royal Air Maroc (1%)
Air Mauritius (2,3%)

Source: CAPA- Centre for aviation and Innovata

Company's share are currently traded on the London Stock exchange and Spanish Stock exchanges.

Currently the IAG is developing a series of scalable platforms related to the IT and back office functions that will facilitate the new entry of other carriers in the group. Nowadays the major part of the company's profitability comes from the long haul markets especially the Americas ones. On the national and domestic side, IAG has to face the crescent power of the low-fares carriers such as Ryanair and Easyjet, which are acquiring a larger market share every year providing a quality-price service hard to compete in a current economic situation remembering the high sensitivity between aviation market and GDP. IAG's mission is to be the leading international airlines company in the future industry consolidation, both on a regional and global scale and we strongly believe that further airlines will join the Group taking advantage from synergies and economies of scale

IAG planned revenue synergies and cost saving



Source: IAG; CAPA- Centre for aviation and Innovata

Revenue synergies and cost saving

As we can see from the exhibit above, in 2011 the initial synergies target of €72 million was largely exceeded of €62 million. Always looking at the graph we can figure out that cost saving will gradually exceed the revenue synergies in the next three years.

Revenue Synergies	Cost Synergies
Fare combinability across BA and Iberia	Sales force integration in BA and Iberia home markets and many other
Codeshare in 33 destinations	Numerous joint purchases made using economies of scale
Cross selling through airline channels	Joint crew hotel accommodation
Cargo single business with increased network	Single management teams in several airports
Avios single currency customer loyalty programme	Sharing of customer lounge facilities
Cargo- joint trucking deals, joint customer incentives	Benefits from engineering services
	Restructuring of IT departments

Source: IAG

The Business segments:

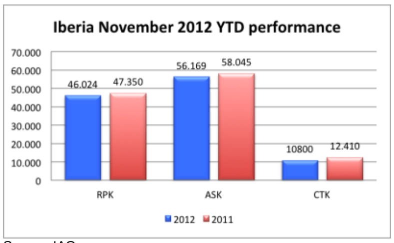
Iberia

Founded in the June of 1927, Iberia Lineas Aéreas de España is the Spanish flag carrier, which operates in the domestic and international market. The company, which operates from its main hubs located at Madrid Barajas Airport, is leader in the Spain to Latin America market with 18 daily departure every day to that area. Iberia has a fleet of 103 aircraft in service flying to 102 destination in 37 countries and owns 45,85% of the total share capital of Air Vueling, a low-fares Spanish carrier. Currently the firm is facing one of the most difficult moment in its history due to the persistence of numerous structural problems that led the Spanish arm of the group to burn €1,7 million every day of operation deriving from the unprofitable short haul network and high employee costs. IAG's CEO Willie Walsh said that Iberia is definitely fighting for survival and a detailed transformation plan has been announced on day 9 November after the 3Q earnings announcement. We are going now to analyse this restructuring plan point by point trying to figure out how IAG will try to recover the Spanish business unit.

Oneworld alliance member airlines
airberlin
American Airlines
British Airways
Cathay Pacific
Finnair
Iberia
Japan Airlines
Lan
Mexicana
Qantas
Royal Jordanian
S7 Airlines

Source: Oneworld

Iberia transformation plan:

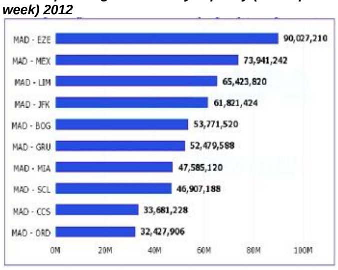


Source: IAG

- Stem Iberia's cash losses by mid-2013;
- Turnaround in profitability of at least €600 million from 2012 levels to align Iberia with IAG's target return on capital of 12 per cent by 2015
- Network capacity cut by 15 per cent in 2013 to focus on profitable routes
- Downsizing its fleet by 25 aircraft – five long haul and 20 short haul
- Reduction of 4500 jobs to safeguard around 15.500 posts across the airline. Thisis in line with capacity cuts and improved productivity across the airline
- New commercial initiatives to boost unit revenues including increased ancillary sales ans website redesign
- Discountinue non-profitable third party maintenance and retain profitable ground handling services outside Madrid
- The trasformation will be funded from Iberia's internal resources

Network reshaping

Iberia top 10 largest routes by capacity (seats per week) 2012

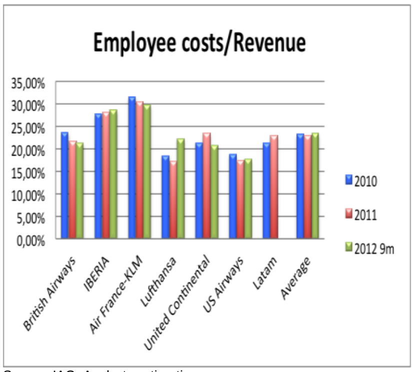


Source: CAPA- Centre for Aviation and Innovata

Starting from the network reshaping, Iberia does not have any long haul flight after midday and so there is an excess of short haul non-profitable routes causing most of the losses of everyday operations. As we mentioned before, IAG has to compete with the strong power of the low-cost carrer in the domestic and european market and the first reaction the Group made was to launch the a low-fares subsidiary Iberia Express during last June which was immediately profitable during its first three months of operations. Apparently this was not enough to recover losses and gain part of that market share lost during these last three years. Hence, from 1Q 2013 15% of the network will be cut focusing just on profitable routes, and two years of profits will be given to these "new" routes to be considerated profitable, if not they will be cut as well.

Aircraft	2012	2015	Deliveries 2012-2015
Airbus A340/A330s	33	29	8
Airbus A320	77	52	9
Total	110	81	17

Source: Iberia; CAPA-centre for aviation and Innovata



Source: IAG; Analysts estimations

The Fleet

Consistent reductions will be applied also to the fleet which will see a downsizing of 25 aircrafts, 5 operating in the long haul and the remaining 20 in the shorthaul. Still not possible to know which aircrafts will be removed wheter owned or leased (finance or operating leases) even if in our opinion the top management will opt for a mix composed mainly from operating leases and just a small part from finance ones in order to avoid penalties due to early contract termination.

Jobs reduction

Definitely the theme that caused the strongest turmoil during the last two weeks, the announced jobs reductions of 4.500 posts has been welcomed from SEPLA, the Iberia pilots' union, as an attempt to dismantling the company and they stated to strike week before Christmas. In fact, during the days 14-17-21 of December, Iberia's staff will not serve the feed the carrier's operations and the union leader will try to found in the government an ally and figure out a solution to mediate with Willie Walsh, considering the already tough Spanish situation characterized by an unemployment rate of 26%. Iberia staff costs over revenue present a value of 28% whereas the average of the industry lies around 23%. On the other hand IAG's CEO is truly convinced about this reduction already did from his biggest rivals such as Lufthansa and Air France–Klm which started to enjoy benefit from 3Q 2012. Furthermore, Walsh stated that if IAG will not find an agreement with Iberia's union until the end of the year, the Group will have to take stronger and deeper actions consisting in further jobs scraps. Finally, on November 30th IAG and British Airways have filed a claim in the UK High court against SEPLA due to the 18 days of strike performed during the period between December 2011 and April 2012 for the launch of the new subsidiary Iberia Express

New commercial initiatives and sources for restructuring

New brand and website redesign to boost ancillary revenues

The target operating profit for 2015 of €1,5 billion has been incremented to €1.6 billion during last weeks and in order to achieve this goal and return Iberia profitable with of at least €600 millions from 2012 levels IAG understood that marketing and ancillary revenues could provide a significant slice of this cake.

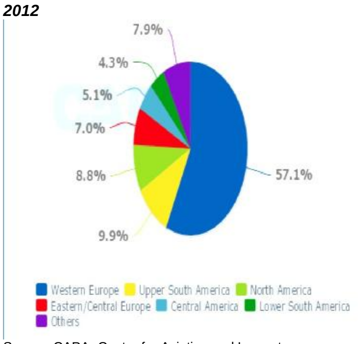
Hence, a website redesign will be done during this period and likely also a fresher version of the Iberia’s brand could be possible in the 1Q 2013. Talking about the expenses of this transformation plan, IAG estimated that will be nearly €300 million and it will be carried out completely with internal resources. Therefore we believe Iberia will sell a significant part of its stake in Amadeus Holding S.A, the Spanish GDS company which takes care about the ticketing side of the airlines’ flights. Currently the Spanish flag carrier holds 7,5% of Amadeus’s equity with a value of €421 millions written in IAG balance sheet as available-for-sale-financial-asset.

Profitability and markets analysis

Double airport taxes at Madrid Barajas and Barcelona El Prat

Underlying Spanish market conditions still tough with a first injection of €37 billions from ECB for the recapitalization of the four main national banks that will arrive to Madrid during this week. This is just a fragment of the whole package of €100 billions that Bruxelles will deliver to Spain during the next moths. Spain is going through the fifth years of economic slump and fortunately 2013 forecasts show modest improvements in GDP after having reached its minimum values of -1,8% in the FY 2012. Furthermore AENA (Aeropuertos Españoles y Navegación Aérea) on 1 July 2012 doubled the airport departure taxes at the main Iberia’s hub such as Madrid Barajas and Barcelona El Prat and Iberia did not apply these charges to customers who bought ticket before this date. Hence this caused €20 millions of additional costs for the flag carrier and affected even further the already flat Spanish market.

Iberia international capacity (%seats) by region in 2012



Source: CAPA- Centre for Aviation and Innovata

Then, talking about where the profitability comes, the domestic market is nowadays the thorn in the side for Iberia which has an excess of point-to-point daily flight causing the largest part of the losses. Iberia is responsible of the 25%-28% of the total Group turnover and whereas almost the half derived directly from the Spanish market.

The LatAm Market

Latin America’s leadership is at risk

Due to cultural affinities, a strategic and new hub in Madrid, Iberia has always been the leading airlines company in the Spain-Latin American routes. In fact, with 19% of its total international capacity, Latin America represents definitely Iberia’s core long-haul market.

European competitors are increasing capacity

In 2Q2012 unit revenue measured in RASK rose 7,5% in a year-on-year comparison, representing the larger gain in RASK for IAG's markets despite a decrease of 2,2% in capacity. Anyway, Mr Walsh state that unit revenues can grow further due to a better management performance. As matter of fact, according to CAPA (Centre for Aviation) "Iberia offers the widest network and the most capacity on routes from Europe to Latin America; however it does not have a dominant position in any of the largest markets. Furthermore, while the Spanish arm of the Group is continuing to cut capacity, European competitors such as Air France-KLM and Lufthansa are adding seats and increase flight frequencies.

Then, on the other side, Iberia has to stumble across the flourishing of small and medium size Latin American carriers that offer competitive prices for flights from South America to Europe and investing in new fleet toward mergers and acquisitions. Aerolinas Argentinas holds a 25% market share on routes from Argentina to Western Europe against the 27% held by Iberia. In November 2012 traffic statistics show a -1,6% passengers carried to Latin America and Caribbean on a year-to-date comparison with 2011 and a decrease of -0,1% in RPK, -1,7% in ASK and an increase of +1,3pts Passenger Load Factor (PLF).

Main European Airlines capacity to Latin America 2012

Carrier	Destinations	Seats to/from	Frequencies to/from
Iberia	17	56,545	172
Air France	16	51,052	169
TAP Portugal	11	36,990	157
Lufthansa	6	28,340	92
KLM	13	23,480	70
Air Europa	9	19,072	64
British Airways	17	14,864	54
Alitalia	4	14,346	56
Virgin Atlantic	8	1524	4

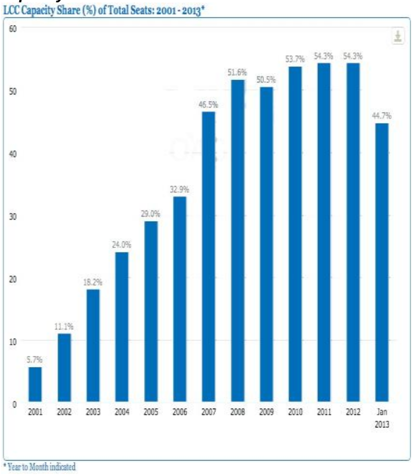
Source: CAPA-Centre For Aviation and Innovata

Iberia Express

Iberia Express: not a tipical LCC

Coming back to the European market, the scene shows a significant increase of market share in favour of LCC (Low-cost carriers) such as Ryanair and Easyjet which applying low fares to customers in a always wider range of destinations throughout the European territory are able to control the short haul and point-to-point service. As we said before, Iberia reacted launching last June the new subsidiary Iberia Express that has been immediately profitable. According to its CEO, the new subsidiary will not be a traditional LCC, providing the same quality of the mainline and applying a four-tiered structure.

LCC market share Spain-International in terms of capacity 2012



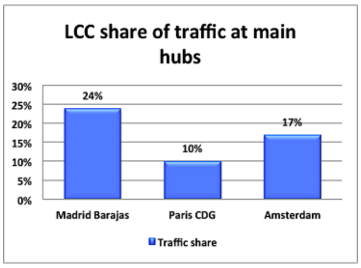
Source: CAPA-Centre for Aviation and Innovata

In Madrid LCCs are logistically advantaged compared to other cities because they do not operate in secondary airports. In fact both Ryanair and Easyjet have their hub in Barajas Airport, even closer to the city centre than Iberia, which operates in the new Terminal 4. Furthermore, due to the central position of Madrid in the Spanish territory, the high-speed rail that is constantly growing nowadays threatens the short haul network as a substitute product. Transfer passengers represent the 70% of long haul passengers in Madrid Barajas, hence there is desperate need of a point-to-point service which connects the long flights and that ensure a stable source of profit. In the meantime, IAG management have found another feasible solution in the takeover of Air Vueling, announcing the will make a bid of €113 millions in 1Q 2013 for the 54,15% of the total share capital, whereas the other 45,85% is already owned by Iberia.

In fact, the Barcelona based carrier, has been one the few Spanish companies that increased capacity during these nine months of 2012 amplifying the number of its routes outside Spain. We will go more into details about the Vueling takeover in the next paragraphs.

African market still showing good opportunities

Africa's market, still challenging for IAG and for all the other international carriers. Anyway IAG has always shown a great interest especially in the sub-Saharan area and in November 2012, year-to-date traffic statistics prove a steep increase in traffic and seats with number of total passenger carried +15,5%, RPK +11,4% and ASK +8,8% respect 2011 (Group performance). Currently Iberia has 31 routes directed to the African continent departing from its main hub Madrid Barajas.



According to our analysis Iberia will be able to return profitable just in FY 2014 with an operating profit of €19 millions while we forecast a FY 2012 and FY 2013 operating loss of €389 and €217 millions respectively. Total passenger revenues will increase for 1,35% in FY 2012 respect FY 2011 but fuel costs 20% up summed with the previously descripted structural problems, will force the Spanish carriers to incur in a significant loss, deeper than the one achieved in FY 2011.

Capacity growth measured in ASK will be down -2,5% in FY 2012 and up 1,0% in FY 2013. Traffic volumes measured in RPK will be down -1,0% in FY 2012 and 0,50% up in FY 2013. FY 2015 in our opinion will be the year where we will see a real solid Iberia with an operating profit of €191 millions. Fuel cost, will be down -4,5% in FY 2012 but they will rise again of approximately 7,5% from FY 2013 to FY 2016.

A tough year for cargo business

On the cargo side, the business unit created in April 2011 announced on 25 November its quarterly results for the period July to September 2012 whereas revenue of €298 millions up +3,5% against the same quarter of 2011.

However, as we mentioned at the beginning talking about the industry, 2012 has been a tough year for the overall cargo sector even though IATA (International Air transportation Association) forecasts for 2013 show cargo business to recover quickly this year. On the specific Iberia's side we forecast cargo down -2,50% in the FY 2012 while a slight improve of 1,0% in the FY 2013.

New maintenance contract for Orbest Airlines

Additionally, on 28 September 2012 Iberia Maintenance signed a three-year contract with Orbest Airlines where it will take care about the maintenance of components of the Airbus' fleet of the Palma de Mallorca based Airlines.

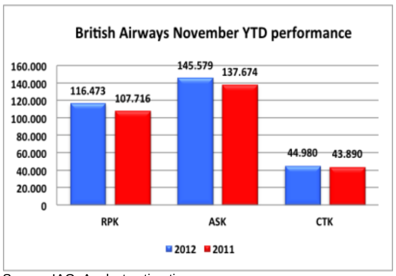
Finally,if the past is a good teacher, the restructuring plan carried out by Willie Walsh to British Airways in 2005 has proven to be crucial for the long-term operation of the British carrier, creating a solid and profitable company, hence we do believe Iberia transformation plan could stem the losses of the Spanish arm achieving an operating profit of €294 millions in 2016.

British Airways

Founded in the 31st March 1974 in London, British Airways is the UK's largest carrier, with a total fleet of 245 aircraft in service (December 2011). It flies over more than 400 destinations worldwide and is one of the leaders in the premium travel market. As Iberia, also British Airways is member of the Oneworld Alliance and through joint business agreements and codeshares, the company presents one of the wider range available in the market regarding routes and services to propose to its customers. Its main important hubs are situated in London:

Heathrow, Gatwick and London City airports even though Heathrow Terminal 5 is still the principal hub for the company's operations.

Profitability and markets analysis



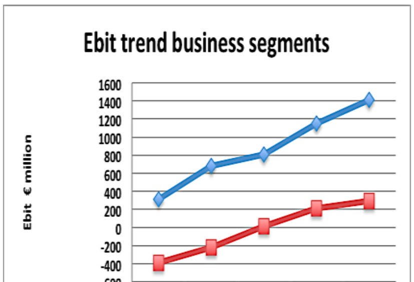
Source: IAG; Analyst estimation

Currently the strong arm of the Group, British Airways is establishing which have to be the future standards for the Spanish sister Iberia. In fact, toward the joint business with American Airlines it is going to reinforce its already significant market share in the North Atlantic area, where the airline has the most profitable routes of its entire business. November 2012 YTD traffic data, clearly show this trend with total passengers carried in North America up 6,4% respect the same period of 2011, RPK +6,8%, ASK +4,1% and PSL (%) +2,1 pts (group performance - Iberia has just few routes to North America). Latest new of 2012 always related to the North Atlantic market, BA will increase flight frequencies from Toronto to London Heathrow from march 31st 2013 reaching 17 flights per week from this destination.

Flight frequencies increase in the North Atlantic market

On 6 September 2012 the company announced the end of its 17-years joint business with Qantas Airlines. The Australian carrier, incurred in financial difficulties during the last months, found in Emirates Airlines a new strategic partner to raise its short and long-term operations. On the other hand, the British operator signed a revenue-shared deal with its Oneworld partner Japan Airlines. The Japanese carrier rose up in March 2011 after filed for bankruptcy and now it represents a good partner to extend IAG's network in the medium term. On the 2nd December BA started a new connection London Heathrow-Seoul with six flights per week showing its will to expand its Asian market share.

End of the joint business with Quantas and new agreement with Japan Airlines



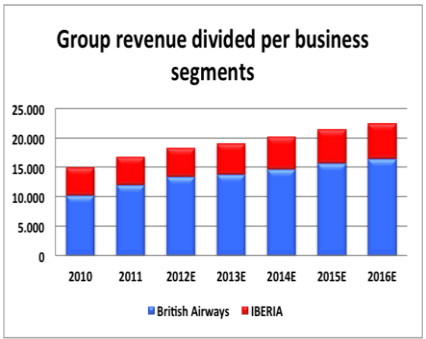
	2012E	2013E	2014E	2015E	2016E
British Airiways	312	684	808	1146	1411
Iberia	-389	-217	19	213	294

Source: Analyst Estimations

Keep on talking about the new opportunities, Chinese market seems to be the most interesting one for BA and it could be a strong source of revenue if the company could establish a qualitative connection Europe-to-China increasing capacity in the next years. Asian airlines companies can enjoy significant amount of capital and local carriers are competing without any restraints to grab new customers. Nowadays the BA provides three Chinese destinations to its clients, Beijing and Shanghai with 13 flights weekly departing from London Heathrow Airport and Chengdu now on sales but in service from September 2013. Willie Walsh stated that the Group selected 10 Chinese cities and carried out which between them are the most "favourite" within its customers. Anyway the Group's CEO added that the project to increase the Chinese routes will be performed from the 3Q2013 due to the arrival of new 24 Boeing 787s and 12 Airbus A380s between May and November 2013.

BMI acquisition from Lufthansa for €207 million last April

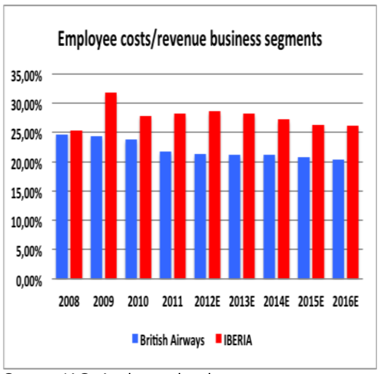
Last April, BA acquired British Midland International and Bmi Baby from Lufthansa for a value of €207 million (£172,5 million) whereas the latter has been disposed during these 9 months of 2012. The new entrant represented 1,9% of the Group capacity growth during the period from January to September 2012 and implemented BA number of destination of 20 routes. This acquisition together with the launch of Iberia Express and the bid for Vueling represent IAG's answer to the progressive growth of low-cost carriers in the European market.



Source: IAG; Analyst estimation

British Airways boasts one of the best premium services worldwide, whereas RPK and yields are constantly growing. The London Olympic Games in summer slowed the revenue flows in the domestic market due to the postpone of leisure and business travel. In 3Q2012 in fact, the carrier came back to 2011 level achieving a 9M2012 operating profit of €286 million, unfortunately offset by an operating loss of €262 million carried out by Iberia during the same period.

Regarding the latest strategic developments, BA signed a joint agreement with Solena regarding the flagship project GreenSky London in order to construct a facility to produce sustainable jet fuel. BA will purchase jet fuel derived from that plant for the next years for a total of $500 million (today prices). Finally we can conclude our market analysis with the clear idea that BA will try to reduce its short-haul market exposure in favour of an expansion in the long haul one, especially in Asia and North America where yields and opportunities seem more attractive.



Source: IAG; Analyst estimation.

After our analysis we do believe that British Airways will enjoy a powerful and straightforward growth during the next for year even though oil fuel prices will remain almost constant to an average of 110 $/barrel.

Our 2012 FY forecast shows an operating profit of €312 millions (£249 million at GDP/EUR rate of 1,25) and a Ebit margin of 2,3%. Then, we estimate a FY2013 Ebit of €684 millions, €166 millions up respect the already great performance of 2011. Ebit margin for FY2013 will improve reaching 5,0%. Ebit upward trend will

Strong financial performance despite high Brent oil prices

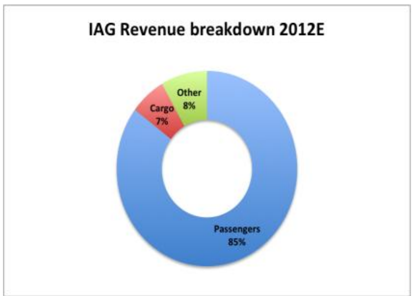
be stronger during the period from 2014 to 2016 touching an operating profit of €1.411 millions in 2016 (£1,138 millions at a GDP/EUR rate of 1,24). Capacity will also show positive yields whereas we expect total capacity (ASK) up 5,50% in FY 2012, due to the new entrance of Bmi in the Group and the new routes to Seoul , Chengdu and increase in frequencies from Toronto. Traffic volume will increase as well with (RPK) up 8,50% in FY 2012 and +6,0% in FY 2013

On the cost side, we expect fuel price causes its hardest damages in FY 2012 up 20% as for the Spanish business unit and decrease of 3,0% in FY 2013. Suppliers cost as well will increase on an average of 6,0% a year due to their close relationship with revenue.

2013E	British Airways	Iberia
ASK	168.707	62.081
RPK	134.962	51.009
Load Factor	81,4	78,9
Passenger revenue	12164	3.897
Cargo Revenue	988	333
Fuel Costs	4647	1.528
Suppliers Costs	4618	1.911

Source: Analyst Estimation

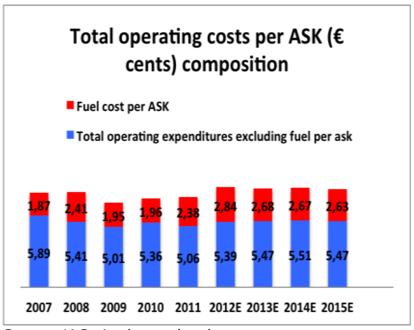
Group forecast analysis



Source: Analyst Estimation

We have started to build our forecasts with Passenger Revenue. This in fact represents our analysis' main trunk, whereas the majority of the further previsions will derive from it. Then Passenger Revenue has been computed multiplying the expected traffic volume (RPK) per "Passenger Yield" where the latter represents a measure of average fare paid per km. The same process has been used for the cargo. We expect both, RPK and Passenger Yield growing for the next year whereas the first will do that at a higher rate. Hence, we estimate passengers growing at an average of 4,5% every year after a FY 2012 high growth of 12,89%.

As we mentioned in the businesses analysis, cargo will recover in 2013 even though we are talking about a slightly growth of an average of 2% per year, until 2016. We strongly believe that the new IAGCargo.com website and the revenue synergies attained through the two main hubs, will place IAG at the top of cargo business in the long-term.

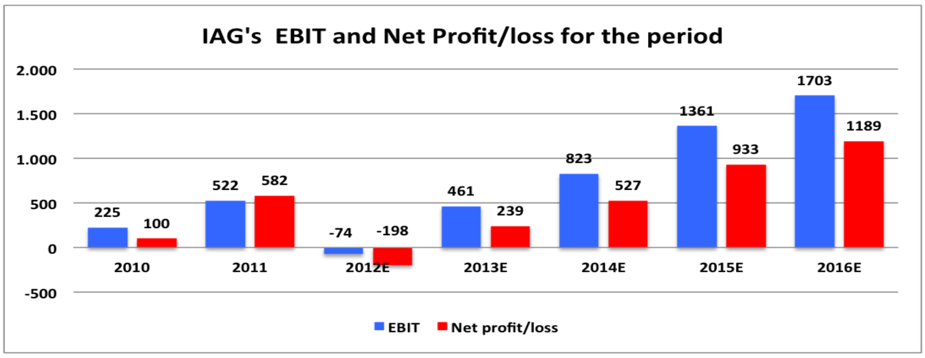


Source: IAG; Analyst estimation

We expect total expenditures on operations for FY 2012 up 16,64% respect FY 2011 mainly due to the steep increase in the fuel price. However, we argue that IAG management will be able implement the so much heralded cost-cutting plan and so we expect total cost from operations to increase only 7% from 2012 to 2016.

Higher number of operating leases to be more flexible in case of turmoil

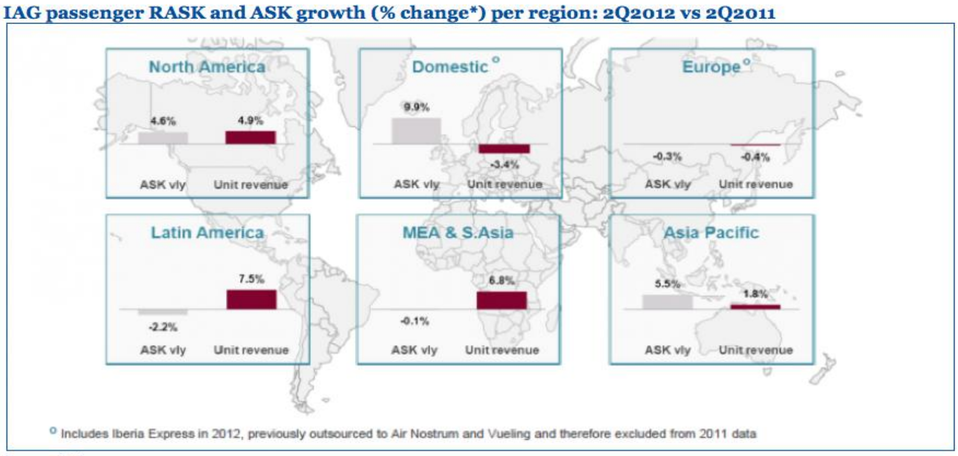
Some hints about the fleet, the Group have shown during this two years a significant reduction of Hire Purchase arrangements in favour of a strong increase in the number of aircraft owned by finance leases and a moderate growth of operating leases contract which, will provide larger flexibility in case of turmoil. Crucial indicator in the airlines sector, expected EBITDAR for FY2012 will be down -15,91% respect to the FY 2011 achieving a value of €1.578 million. Capital Expenditures, wholly committed in USD$ dollars will be down until 2015 where it will see a slightly grow of 1,0% before a larger recover of 3,0% in 2016. Therefore, we forecast a FY2012 operating loss of €74 millions and an operating profit €461 million in FY2013 due to the great performance of BA and the first real effects of the Iberia transformation plan.



Source: IAG; Analyst estimation

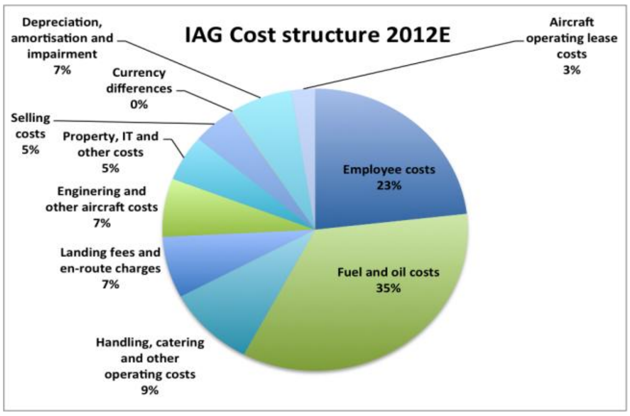
Unit revenue per ASK (RASK) decreased sharply in the domestic market in 2Q2012 year-on-year in the domestic market despite the strong increase in capacity. We expect unit revenues to decrease 4,5% in FY2012 with capacity constant at +10,0%. As we stated before, China and North America remain the biggest opportunities in the term of revenues for IAG: RASK in MEA & S. Asia connections increased of 6,8% in 2Q2012 even though capacity was stuck at 2Q2011 level, sign of a high-growing market with strong chance to increment the company's profitability. European market still frozen in term of capacity and unit revenue whereas the IAG will try to improve results through the new entrants such as BMI and Iberia Express.

IAG passenger RASK and ASK growth (% change*) per region: 2Q2012 vs 2Q2011



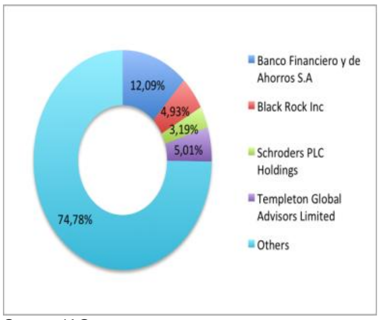
Source: IAG
Note: *% change in revenue per ASK is on like-for-like basis (pre bmi acquisition and at constant currency)

Taking a look to the 2012E cost structure of the group we see that the biggest slices of the pie are represented by the fuel and employee costs. The latter present a value close to the industry average even if, as we said before, Iberia staff costs are by far too high compared to those of its competitors whereas a short haul pilot earns more than a long haul one of BA. Selling cost, a variable cost strictly related to passenger revenues will count for just 5% while handling, catering and other operating costs (variable as well) represent 9% of total operating costs. On the fixed side, property, IT and other costs will count for just a 5% in FY2012.



Source: Analyst estimation

Notwithstanding the several improvements in traffic, capacity and load factor, we believe that the financial target of €1,6 billion for 2015 announced by Willie Walsh is too optimistic. In fact, despite the assistance of further group synergies combined with a strong cost cutting we forecast a FY2015 EBIT of €1.361 billion (already a great result) whereas the 80% will be carried by British Airways and the remaining part from Iberia.



Source: IAG

Shareholder Structure

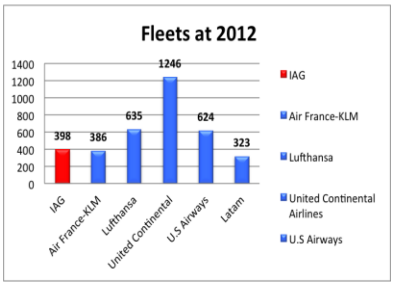
As we can see from the graph, the significant shareholders of the groups are financial services institution. Banco Financiero y de Ahorros S.A, that since last June is no longer a private bank, represents with 12% of the share capital the major shareholder and the sole Spanish one. The American investment corporations Black Rock and Templeton hold 5% of the total share each one and finally the British Asset Management company Schroders Plc Holding owns the 3%.

Comparables

The comparable group we used as our sample is composed entirely by legacy carriers operating in both, short and long haul markets. It includes, Air France-KLM, Lufthansa, U.S Airways, United Continental Holding and Latam Airlines. The first two companies are direct competitor of IAG in the domestic and international market while the remaining three rivals the Group just in the long haul. Air France-KLM merged in 2004 being the first sign of the new tendency in the airlines industry. United Airlines and Continental Airlines merged in 2010 creating the largest carrier worldwide while Lan and Tam gave birth to the biggest carrier in Latin America. In the same in which IAG has to face with a significant job reduction, Air France-KLM and Lufthansa stumble across the same issue when cutting an average of 4000 posts last year to provide a solid financial result and do not affect the companies' operations.

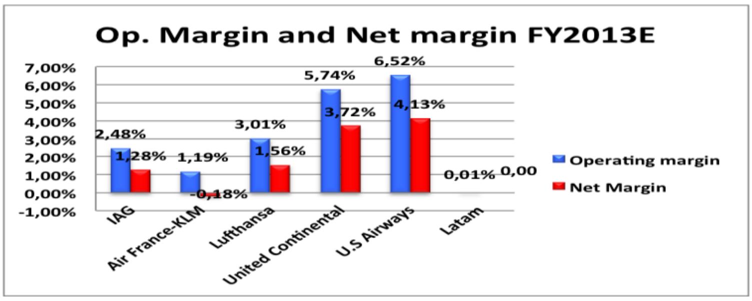
November 2012 YTD traffic statistic	Passenger carried	Variation from 2011	RPK	Variation from 2011	ASK	Variation form 2011	Load factor %	Variation from 2011
IAG	50.563	5,80%	162.496	4,80%	201.747	3,10%	80,50%	1,3
Air France-KLM	71.461	2,20%	205.917	2,30%	247.335	0,70%	83,30%	1,2
Lufthansa	95.950	3,00%	190.250	2,80%	241.036	1,20%	78,90%	1,2
United Continental Airlines	129.364	0,70%	189.278.955	0,70%	229.195.164	1,10%	82,60%	0,3
U.S Airways	57.432.995	2,80%	59.699.457	3,00%	71.245.861	2,50%	83,80%	2,5
Latam	56.649	6,90%	90.915	7,70%	116.000	4,10%	78,40%	2,6
Median	83.706	3%	198.084	3%	244.186	0,02	82%	1,25

Source: IAG; Air France-KLM; Lufthansa; United Continental Airlines; U.S Airways; Latam.



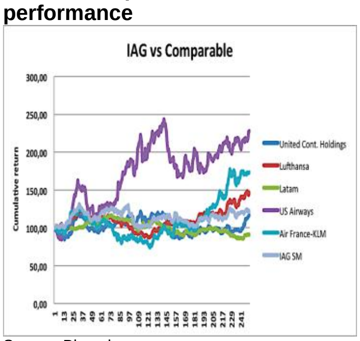
Source: IAG; Air France-KLM; Lufthansa; United Continental Airlines; U.S Airways; Latam

As we can se from the table IAG traffic data on November 2012 YTD are below the median of the industry but the variation from November 2011 YTD clearly shows IAG above the other comparable. In fact, passenger carried increased by 5,8%, RPK rose 4,8%, ASK as well up 3,1% and Passenger Load Factor +1,3 pts against 1,25 of the industry. Talking about the fleets, United Continental plaies a different match from the other in terms of number of aircrafts. On the European side, IAG boasts in the British side a strong and solid fleet that will be enhanced with the arrival of the new Boing 787 and Airbus A380 in the 2Q 2013. We still do not know if some of the new entries will be allocated to Iberia but still clear that the Spanish arm must renew its long haul fleet in order to compete with the crescent investments carried out by the Latin American carriers such as Latam Airlines and Aereolinas Argentinas.



Source: Analyst estimation; 4traders

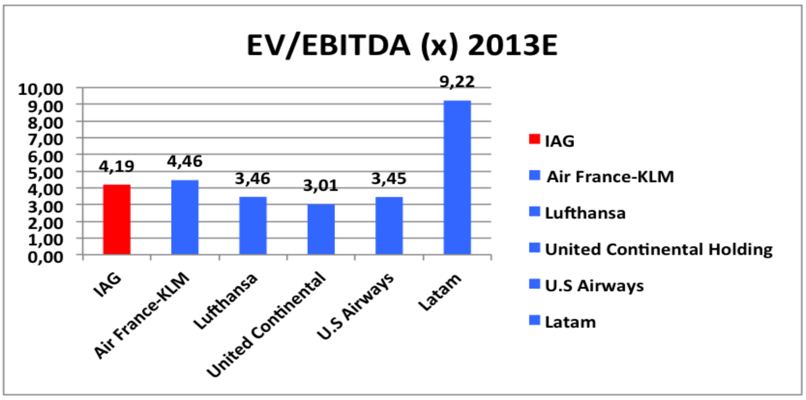
IAG vs Comparable 2012 1Y performance



Source: Bloomberg

In FY2013 we are expecting IAG to show a sharp upturn both in operating and net margin, moving toward the direction of its American competitors although will persists a stark difference of approximately 3,0%. Hence after a great FY2012 for Air France-KLM, we believe the Group will be able to deliver already strong changes in performance, and so exceed the French-Dutch carrier in profits and margin.

Looking at the long term, EV/EBITDA multiples in 2013E clearly show the upward trend of the Group with a value of 4,19 (x) significantly higher than its American competitors such as United Continental and U.S Airways. On the other hand, here we find again an evident sign of the potential growth of Latin American carriers, where Latam Airlines presents a EV/EBITDA of 9,22 (x).



Source: Bloomberg; Analyst estimation

Valuation

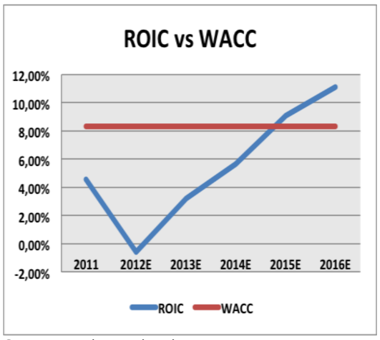
We decided to analyze IAG using a DCF discounted cash flow model where all the free-cash flows are discounted at the weighted average cost of capital. We chose the use of WACC due to the quite stable capital structure of the Group and the tendency to move toward the debt-to-equity target ratio in the next years issuing more debt. Currently IAG presents a D/D+E ratio of 24% and a E/D+E ration of 76% (D and E are considered at market price) whereas the target ratios are respectively 39% and 61%. We expect the Group to get closer to these ratios and increase the use of debt in order to don't renounce to a part of the current tax shield due to the forthcoming decrease in the UK corporate tax that will be set as 22% in 2014.

Said that we took a group of comparable composed by a mix of direct comparable in term of market and peers with the similar capital structure of IAG. Hence we decided to pick the following carrier: Luthansa, Latam, United Continental Holding and U.S Airways.

So, we opted for the MSCI World Index as market portfolio to calculate the coefficient Beta of the five stocks. We want to point out that before 21st January 2011, date when IAG has been created, the Group is just formed as the simple sum Iberia and British Airways.

At this stage we had unlevered all those computed beta and then calculate the average of this obtained beta used an unlevered beta of the industry. Regarding IAG corporate tax rate we used an average rate of 24% considering the 30% corporate tax rate applied in the Spanish territory and the UK one of 22% in 2014 considering also that British Airways is responsible for 75%-80% of the total operating profit of the Group. Hence with relevered the beta using the target ratios of the industry found as averages of all the peers ratios and we figured out a IAG beta of 1,454 almost one point over the beta of the industry of 1,357 meaning that IAG presents a higher sensitivity to the market it is riskier than the overall industry.

WACC and DCF



Source: Analyst estimation

As we said before, we expect IAG to issue more debt in the future moving toward a higher D/E ratio in order to exploit the fiscal effect of the tax shield despite the changes in the UK corporate tax rate. On the other hand believe that this process will be slowly and in a gradual way so we retain the use of WACC as the most appropriate for IAG valuation.

In 2009 British Airways issued £350 millions of 5,8% convertible bonds with maturity in August 2014. This debt is considered as senior debt characterized by a hypothetical recovery ratio of 40% (the real recovery ratio would be available just in case of company bankruptcy). IAG debt comprises short-term borrowing (12%) and interest long-term borrowing (the remaining 88%). In order to estimate the Group's cost of debt we use a IAG's issued CDS 10 years with a value of 5,98%, the German 10 years bond last price of 16-11-2012 as a risk-free rate, the IAG's probability of default of 0,14% (Bloomberg) and finally the recovery rate of 40% related to the senior debt.

Our Rd estimation gave us a value of 7,36%, where it represents the real cost of debt that debt holders will receive even considering all scenarios.

According to literature market premium can assume a number between 6,5% and 4,5% we set a value of 6% in order to properly reflect the current financial situation and so the high stocks volatility in within this macroeconomic situation. Hence we calculate the cost of capital using the Capital Asset Pricing Model plugging inside all the parameters explained until now.

Re= Rf +Beta x Market premium = 10,05%

Therefore picking up again our target D/D+E and E/D+E ratios we compute the weighted average cost of capital. Our estimated WACC has a value of 8,33%.

All the Free-cash flow have been discounted at the just described WACC of 8,33% and at the been computed the following formula:

$$Terminal\ Values = \frac{FCF\ n\ (1+g)}{WACC - g}$$

Whereas FCFn corresponds to the Free-cash flow of 2016 and "*g*" is the real growth rate. Normally "*g*" presents values between 1% and 2% related to mature company hence due to the Spanish macroeconomic situation in current Iberia's structural problem, we select a value of 1%. The sum of the DCF plus the Terminal value will provide us our Enterprise value whereas we deducted the 2013 Net Debt and Minority interests. Now, after we found out the implied EV we can figure out our 2013 price target dividing it for the total number of outstanding shares. Our IAG price target 2013 is €2,44.

Vueling

Source: Bloomberg

On 8 November 2012 IAG announced its will to make a cash tender offer of €113 millions for the 100% share capital of Vueling. IAG already owns 45,85% of the Barcelona based company's capital through its Spanish arm Iberia and reading in the released bid statement on IAG website it seems that the Group will not touch the Iberia's participations in Vueling but it will just try to acquire the remaining 54,15% of the capital. Mr Walsh announced that the takeover will be launched during 1Q 2013 and if the required 90% consense of Vueling shareholders will be reached, the merger will be done and complete in 2Q 2013. IAG offers 7 Euro per share with a premium of 27,29% respect the 8 November last price. Vueling investors have already turned their nose because in their opinion the share price will be worth at least 9 Euro in 2013 with further growing perspective in the short-term. On its side, Vueling has cash for €406 millions and the company could decide to pay a consistent dividend to its shareholders in order to make IAG offer less attractive. Veloz Holdco S.L is the name of the IAG's wholly subsidiary created just for this transaction that will happen in the Spanish stock markets. Additionally is important to underline that the total amount of €113 will be taken from IAG internal resources.

Vueling Market Analysis

Revenue up 26,3% in 3Q2012

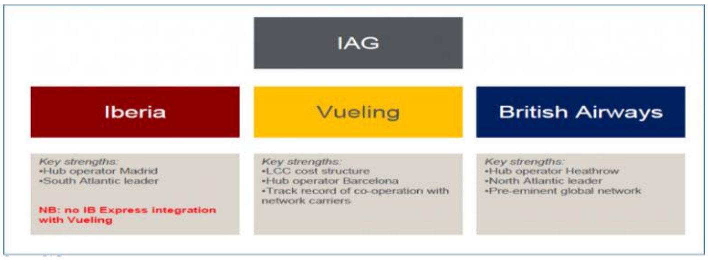
With capacity (ASK) up 30,6% in 3Q 2012 respect the same period of 2011 and number of total passenger doubled in one year, Air Vueling is definitely living the best moment of its history with a perfect financial health and operations at the level. In fact, the Barcelonese Airlines has shown revenue up 26,3% in 3Q 2012 respect the same quarter of 2011. A continuous focus on the international market led the firm to have 54% of the total routes outside Spain. Northern Europe especially Germany and Scandinavia will be the next expansions in 2013. A lean business model characterized by a structure of few fixed cost and high service convinced the company’s CEO Alex Cruz to talk about double digit growth for the FY 2013 during the 3Q 2012 conference call. The top manager also state that in a moment where numerous carriers are cutting their network, especially in the Spanish domestic market (Iberia), Vueling will be ready to take advantage from this downward moment to increase its market share inside and outside Spain. For all these reason and many more, IAG sees in Vueling the right solution to react against low-cost carriers, substituting part of the unprofitable routes of Iberia and exploiting the fresh and dynamic Vueling business model.

Double digit growth in FY2013

For FY 2012 we expect EBIT figure of €21,77 millions almost the double respect the one achieve in FY 2011 of €11,37 million. FY 2012 revenue will be up 25,99% respect FY 2011 as answer of the steep increase in ASK and RPK values. However, from 2013 to 2016 we forecast a smaller growth around an average of 5% per year. On the costs side, we expect operating leases go up due to the further expansion in the international market. Finance leases will decrease in order have a more flexible company and to be ready to adjust possible over capacity situations and meet the changes in demand.

A flexible business model difficult to imitate

IAG’s proposed structure with Vueling entrance in the Group



Source: IAG; Capa-Centre for Aviation and Innovata

Vueling's Valuation

We decided to approach Vueling in the same method that we did for IAG hence using a DCF model discounted at the weighted average cost of capital. We wanted to compute the company 2013 target price in order to understand if the Group offer of 7 Euro per share reflects the fair value of the share. The group of comparable took for the cost of capital computation is formed by the following airlines: Ryainair, Easyjet, Norwegian Air Shuttle, Westjet Airlines and AirAsia. All of them are LCC (low-cost carriers). Air Vueling presents almost the same values on regarding beta unlevered and beta levered due to the lack of long-term bearing debt in its capital structure. Unlike IAG's valuation, in order to figure out Vueling's cost of capital we decided to use also the country beta of Spain with a value of 1,53. We opt for this solution because in our opinion it better explains the systematic risk of Spain presented in the company's operations. Hence we have selected growth rate "*g" of 2%* whereas in our opinion reflects perfectly the current situation of the Spanish carrier nowadays. Our 2013 Vueling target price is 9,615 Euro.

This mean that the offer of 7 Euro per share made from the Group does not reflect the fair value of the company. Hence if the takeover will be done at the offered price, IAG will gain 2,615 Euro per share equal to a total of €42,33 millions considering the 54,15% of the whole capital. Immediately after the announcement of the bid, the market presented a strong overreaction with the price jumping from 5,47 Euro to 6,83 Euro and then stabilises around that level for the following days. We believe that IAG's management offer this first value on purpose in order to negotiate later on at the moment of the real bid. Anyway we think that the takeover will be done due to especially the mutual advantages for both companies where Vueling will be able to exploit the Group's synergies and in the meantime IAG will plug inside its business a profitable and growing carrier.

Conclusion

Arrived at this point, we can draw our conclusions saying that we believe in the Willie Walsh plan to create a leading Airlines company, solid and strong in the medium and long-term after the restructuring of Iberia. Further synergies, cost cutting, lower oil price, GDP growth and the likely entrance of Vueling inside the Group will be the drivers of a flourishing future for IAG.

Hence we strongly recommend to hold the stock.

APPENDIXES

IAG Financial Statements

Income Statement

€ million	2012E	2013F	2014F	2015F	2016F
Passenger Revenues	15.437	15.918	16.641	17.517	18.314
Cargo	1.160	1.190	1.213	1.238	1.263
Other	1.503	1.525	1.548	1.571	1.595
Total Revenue	18.100	18.633	19.402	20.326	21.172
Employee Costs	4.217	4.175	4.154	4.216	4.343
Fuel and oil costs	6.274	5.975	6.065	6.156	6.217
Handling, Catering and other operating costs	1.712	1.798	1.834	1.815	1.806
Landing fees and en-route charges	1.281	1.396	1.480	1.554	1.663
Enginering and other aircraft costs	1.214	1.323	1.402	1.472	1.561
Property, IT and other costs	957	995	1.035	1.066	1.098
Selling Costs	853	793	825	858	892
Currency differences	14	14	14	14	14
EBITDAR	1.578	2.164	2.593	3.175	3.578
D&A	1.194	1.230	1.279	1.298	1.337
Aircraft operating lease costs	459	472	492	515	537
Total operating costs	18.175	18.171	18.580	18.964	19.468
EBIT	-74	461	823	1.361	1.703
Finance costs	-231	-238	-245	-252	-260
Finance income	108	111	115	118	122
Retraslation on currency borrowing	-10	-	-	-	-
Other non-operating costs	-53	-20	-	-	-
Total non-operating costs	-186	-147	-130	-134	-138
Profit/(loss) before tax	-260	314	693	1.227	1.565
Tax	62	-76	-166	-295	-376
Profit/(loss) after tax	-198	238	527	932	1.189

Balance Sheet

€ million	2012E	2013F	2014F	2015F	2016F
Non-current assets					
Property plans and equipment	10.257	10.769	11.105	11.438	11.781
Intangible assets	2.121	2.184	2.293	2.454	2.626
Available-for-sale-financial assets	610	610	610	610	610
Other non.current assets	2.445	2.515	2.596	2.687	2.782
Total non current assets	**15.432**	**16.078**	**16.604**	**17.188**	**17.798**
Current assets					
Inventories	400	400	400	400	400
trade receivables	1.321	1.360	1.416	1.483	1.545
Cash and cash equivalents	1.839	1.747	1.659	1.825	2.099
Other current assets	2.413	2.453	2.494	2.632	2.778
Total current assets	5.972	5.959	5.969	6.340	6.822
Total assets	**21.404**	**22.037**	**22.573**	**23.528**	**24.620**
Dividends paid	-	-	- 500	- 900	- 1.100
Total shareholder's equity	5.188	5.428	5.454	5.487	5.576
Non-controlling interest	300	300	300	300	300
Total equity	5.488	5.728	5.254	4.887	4.776
Non-current liabilities					
Interest-bearing long-term borrowing	4.947	5.281	6.085	7.216	8.165
Employee benefit obbligations	305	323	343	363	400
Derivative financial instruments	112	119	126	133	141
Other long-term liabilities	2915	2.916	2.916	2.916	2.916
Total non current liabilities	8.279	8.638	9.470	10.628	11.622
Current liabilities					
Current portion of long-term borrowing	692	713	730	761	796
Trade ond other payables	6272	6.271	6.412	6.545	6.718
Othe current liabilities	673	689	708	708	708
Total current liabilities	7637	7.672	7.849	8014	8222
Total liabilities	15.916	16.310	17.319	18.642	19.844
Total equity and liabilities	21.404	22.038	22.573	23.529	24.620

Cash-Flow statement

€ million	2012E	2013F	2014F	2015F	2016F
EBIT (1-t)	-57	351	626	135	1.294
D&A	1.194	1.230	1.279	1.298	1.337
Gain/(losses) and others	34	70	87	90	93
Cash flow from operating activities	**1.172**	**1.650**	**1.992**	**2.442**	**2.724**
CAPEX	1.866	1.742	1.614	1.631	1.680
Inventories	-	-	-	-	-
Trade receivable	146	39	56	67	62
Trade and other payables	895	-1	141	133	173
Changes in NWC	-749	-	-85	-66	-112
Change in other assets	972	174	231	389	413
Change in other Liabilities	170	23	26	8	8
Cash flow from investing activities	**1.919**	**1.933**	**1.734**	**1.947**	**1.973**
Free cash flow to the firm	**-747**	**-284**	**257**	**476**	**750**
Interest paid	-231	-238	-245	-252	-260
Tax shield	55	57	59	61	62
Changes in financial liabilities	894	446	909	995	710
Changes in employee benefit obbligation	28	18	19	21	37
Changes in equity	-	-	-1.000	-1.300	-1.300
Cash flow from financing	**747**	**284**	**-257**	**-476**	**-750**

Business Segments P&L Statements

IBERIA P&L Statement

€ million	2012E	2013F	2014F	2015F	2016F
Passenger revenue	3694	3897	4170	4420	4641
Cargo revenue	330	333	346	353	360
Other revenue	933	975	1024	1060	1087
Total revenue	4957	5206	5541	5834	6088
Employee costs	1421	1471	1508	1538	1592
Fuel costs	1600	1528	1543	1589	1645
Suppliers costs	1820	1911	1959	2008	2139
EBITDAR	116	296	531	698	713
Ownership costs	505	518	523	508	487
Operatig profit/(loss)	-389	-222	8	191	226

British Airways P&L Statement

£ million	2012E	2013F	2014F	2015F	2016F
Passenger revenue	9419	9890	10384	11059	11723
Cargo revenue	772	803	835	869	903
Other revenue	551	562	573	599	620
Total revenue	10742	11254	11792	12526	13246
Employee costs	2291	2383	2502	2602	2706
Fuel costs	3895	3778	3854	3950	4049
Suppliers costs	3542	3755	3980	4219	4493
EBITDAR	1013	1338	1456	1755	1997
Ownership costs	764	783	810	838	859
Operatig profit/(loss) £	249	556	646	917	1138
Operatig profit/(loss) €	312	684	808	1146	1411

Vueling Financial Statements

Income statement

Thousand of €	2012E	2013F	2014F	2015F	2016F
Revenues	1.027.873	1.089.546	1.144.023	1.201.224	1.261.285
Other operating income	60.000	63.000	66.150	69.457	72.930
Total Revenue	**1.087.873**	**1.152.546**	**1.210.173**	**1.270.682**	**1.334.216**
Fuel cost	309.319	303.132	310.711	318.479	321.663
Employee costs	82.433	85.731	89.160	91.835	94.590
External services	546.600	601.260	637.336	675.576	702.599
Gain/(losses) on disposal assets	- 150	-	-	-	-
EBITDAR	**149.671**	**162.422**	**172.966**	**184.792**	**215.363**
Depreciation	7.145	7.574	8.028	8.510	9.021
Aircraf Operating leases	120.752	127.998	135.677	143.818	152.447
Total operating costs	**1.066.100**	**1.123.695**	**1.180.913**	**1.238.218**	**1.280.320**
EBIT	**21.773**	**26.851**	**29.260**	**32.464**	**53.895**
Financial results	6.715	7.648	7.918	8.551	9.235
EBT	28.488	34.499	37.178	41.015	63.131
Income tax	8.546	10.350	11.153	12.305	18.939
Net Income	**19.942**	**24.149**	**26.025**	**28.711**	**44.192**

Balance sheet

Thousand of €	2012E	2013F	2014F	2015F	2016F
NON-CURRENT ASSETS					
Inìtagible Assets	73.100	76.755	82.128	86.234	92.271
PP&E	2.500	2.575	2.652	2.732	2.814
Othe Non-current assets	170.437	174.979	183.244	192.089	202.904
Total non-current assets	246.037	254.309	268.024	281.055	297.988
CURRENT ASSETS					
Inventories	353	353	353	353	353
Trade and other receivables	59.452	62.987	66.136	69.443	72.915
Cash and Cahs equivalents	75.000	79.500	84.270	91.012	98.293
Other current assets	257.762	269.600	288.272	308.451	330.379
Total Current assets	392.567	412.439	439.031	469.259	501.940
TOTAL ASSETS	**638.604**	**666.748**	**707.056**	**750.313**	**799.928**
Total shareholder equity	222.614	246.763	272.788	301.498	345.690
Changes in values adjustments	26.863	26.863	26.863	26.863	26.863
Total equity	249.477	273.626	299.651	328.361	372.553
NON-CURRENT LIABILITIES					
Long-term provisions	166.284	144.386	156.206	168.239	171.098
Other non current liabilities	27.569	27.644	27.721	27.801	27.883
Total non-current liabilities	193.853	172.030	183.927	196.040	198.981
CURRENT LIABILITIES					
Debt with credit institutions	3.078	3.078	3.078	3.078	3.078
Trade payables	116.972	119.312	121.698	124.132	126.615
Other current liabilities	75.224	98.702	98.702	98.702	98.702
Total current liabilities	195.274	221.092	223.478	225.912	228.395
Total liabilities	389.127	393.122	407.405	421.952	427.376
Total equity and liabilities	**638.604**	**666.748**	**707.056**	**750.313**	**799.928**

Cash flow Statement

Thousand of €	2012E	2013F	2014F	2015F	2016F
EBIT (1-t)	15.241	18.795	20.482	22.725	37.727
D&A	7.145	7.574	8.028	8.510	9.021
Other gain/(losses)	7.171	7.899	8.215	8.873	9.582
Cash flow from operating activities	**29.558**	**34.269**	**36.726**	**40.107**	**56.330**
Capex	6.717	7.649	8.106	8.590	9.103
Inventories	-	-	-	-	-
Trade receivables	12.264	3.534	3.149	3.307	3.472
Trade Payable	15.257	2.339	2.386	2.434	2.483
Changes in NWC	-2.993	1.195	763	873	990
Change in other Assets	-33.697	20.035	32.311	33.130	38.780
Change in other Liabilities	14.181	1.655	11.897	12.113	2.940
Cash flow from investing activities	**-44.154**	**27.223**	**29.283**	**30.479**	**45.931**
Free cash flow from to the firm	**73.712**	**7.045**	**7.443**	**9.628**	**10.398**
Interest paid	-3.531	-3.636	-3.818	-4.124	-4.454
Tax shield	1.059	1.091	1.145	1.237	1.336
Changes in financial liabilities	-59.269	-4.500	-4.770	-6.742	-7.281
Changes in equity	-11.972	-	-	-	-
Cash flow from financing	**-73.712**	**-7.045**	**-7.443**	**-9.628**	**-10.398**

Disclosures and Disclaimer

Research Recommendations

Buy	Expected total return (including dividends) of more than 15% over a 12-month period.
Hold	Expected total return (including dividends) between 0% and 15% over a 12-month period.
Sell	Expected negative total return (including dividends) over a 12-month period.

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